Economic Outlook and Fiscal Review

ONTARIO 1987

Ontario

Ministry of
Treasury and
Economics

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Preface

The annual Economic Outlook and Fiscal Review is part of the Government's efforts to enhance the pre-budget discussions and consultative process, leading to the development of Ontario's annual Budget.

In Spring, 1986, the Legislature set up the Standing Committee on Finance and Economic Affairs to "consider and report to the House its observations, opinions and recommendations on the fiscal and economic policies of the Province." This Review has been prepared to assist the Committee, other members of the Legislature and the general public in deliberations and discussions on the forthcoming 1988 Ontario Budget.

The Ontario Economy: Performance and Prospects

Ontario Economic Outlook at a Glance

	1986	1987	1988
Real Growth (%)	4.9	3.9	2.8
Inflation (%)	4.4	5.1	4.7
Job Creation (000s)	153	146	105
Unemployment Rate (%)	7.0	6.2	5.8

The Ontario economy is heading into its sixth consecutive year of growth.

1987 Performance: Strong Growth

The Ontario economy has continued to grow very strongly in 1987. Ontario's real output for the first six months grew at a rapid 4.4 per cent annual rate. Growth has been driven primarily by strong personal consumption and business investment.

- Ontario retail sales rose by 10.1 per cent during the first nine months of 1987 compared to the same period last year. Strong automotive sales and housing-related expenditures were key factors.
- Business investment is expected to exceed $25 billion this year, supported by solid gains in spending on machinery and equipment and non-residential construction.
- The housing market continues to be strong. Housing starts increased by 40.4 per cent for the first nine months of 1987 compared to the same period in 1986.

Strong economic growth has led to substantial employment gains and a lower unemployment rate.

- In the first eleven months of this year, the Ontario economy created an average of 145,000 jobs.
- The unemployment rate was 5.9 per cent in November, 0.8 percentage points lower than a year earlier.

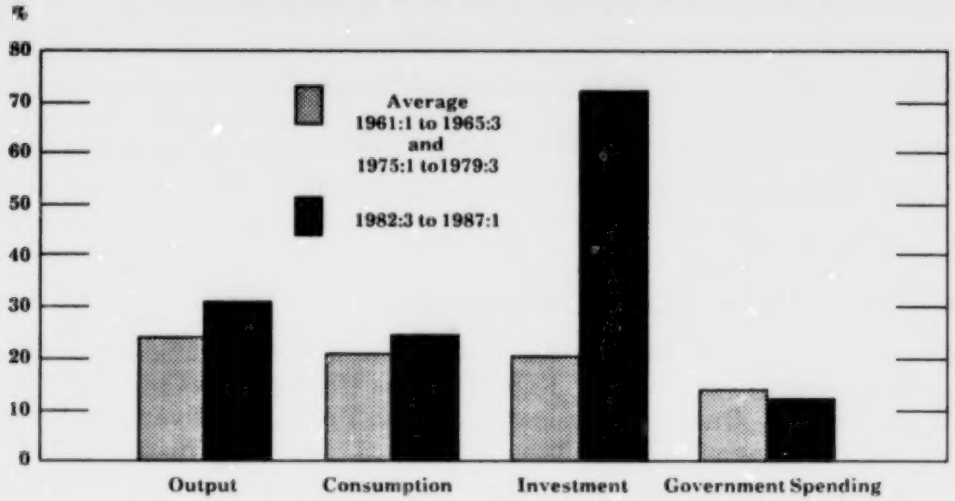
In 1985 and 1986, the Ontario economy outperformed the rest of Canada. Over those two years, Ontario's real output expanded by 10.3 per cent compared to 6.1 per cent for the rest of the country. In 1987, the growth gap narrowed. Real output in Ontario is expected to grow by 3.9 per cent this year compared to 3.5 per cent in the rest of the country.

An Historical Perspective

The current economic expansion has continued without interruption for over five years. This ranks as the second longest expansion since 1950, surpassed only by the 52-quarter expansion spanning the 1961-1973 period.

The first eighteen quarters of the current expansion compare favourably with the first eighteen quarters of the 1961-1973 expansion and the eighteen quarter expansion of 1975-1979. Real output has risen by over 31 per cent, significantly greater than the average 24.2 per cent increase recorded over similar stretches of the two previous lengthy expansions. Job creation has totalled 608,000, significantly more than the average 472,000 jobs generated over the two previous comparable periods.

REAL GROWTH DURING MAJOR EXPANSIONS



Source: Ontario Ministry of Treasury and Economics.

Investment (including residential housing) has also been considerably stronger than in the previous expansions. Spending by all levels of government has grown relatively more slowly over the current cycle, rising by only 12.2 per cent, compared to an average of 14.2 per cent during comparable periods in the 1961-1973 and 1975-1979 expansions.

1988 Forecast: Continued But Moderate Growth

The recent crash of equity values on stock markets around the world has injected a new element of uncertainty into the 1988 forecast. However, despite the uncertainties remaining as a result of the market crash and subsequent reactions, the forecast is that the current expansion of the Ontario economy will continue in 1988, but at a more moderate pace than previously expected.

- Real GDP growth will decelerate from 3.9 per cent in 1987 to 2.8 per cent in 1988.
- Job creation is forecast at 105,000 in 1988, representing a 2.2 per cent increase in employment.
- The unemployment rate in 1988 is expected to average 5.8 per cent.
- CPI inflation in Ontario is forecast to moderate to 4.7 per cent next year.

More details on the Ontario economy's performance in 1987 and an outlook for 1988 are presented later.

Key Factors and Assumptions: 1987-1988

The Ontario economy is highly sensitive to growth in key export markets and changes in important international prices.

- Economic growth in the U.S., Japan and Europe.
- Economic performance in the rest of Canada.
- International and domestic financial markets.
- Energy prices.

The United States, Japan and Europe

Economic growth in the United States has a very strong influence on economic activity in Ontario. Exports to the United States represent about 32 per cent of Ontario's Gross Domestic Product. Every additional percentage point of real growth in the U.S. typically means about 0.4 percentage points of extra real growth in Ontario.

In 1987, economic growth in the U.S. resulted more from U.S. export growth than expansion of domestic demand. The lower value of the dollar bolstered competitiveness and stimulated manufacturing activity. Strong employment gains during the first half of 1987 pushed the U.S. jobless rate below six per cent for the first time in eight years.

After five years of improving price performance, CPI inflation in the U.S. doubled from 1.9 per cent in 1986 to about 3.8 per cent in 1987 in response to increased energy and import costs. Inflation fears and tightening monetary policy by the Federal Reserve Board raised interest rates during the spring and late summer.

After rapid increases in equity prices during most of 1987, the prospects of higher inflation and higher interest rates and the very high price-earnings ratios for equities contributed to the plunge in stock values around the world. In the U.S., the Dow Jones lost over 30 per cent of its peak value by the end of November. To restore confidence and stability, the Federal Reserve, in concert with other central banks, lowered interest rates sharply.

Notwithstanding these policy responses, the stock market crash may have the effect of raising the personal savings rate by over one-half of a percentage point as households reduce spending. This could reduce consumer spending by $20 to $27 billion in 1988.

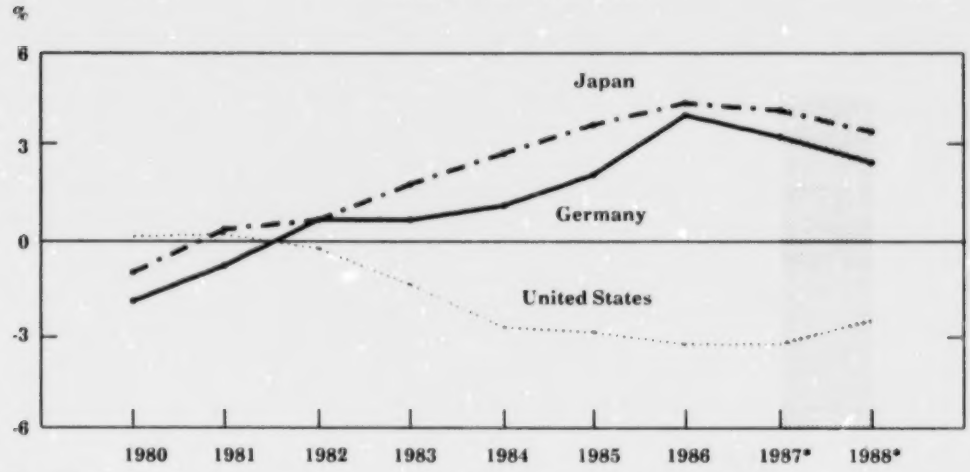
On net, the major drop in equity values has lowered most forecasts of U.S. growth in 1988. The crash has cut forecast growth by slightly more than 0.5 percentage points.

The stock market crash has focussed renewed attention on U.S. fiscal policy. U.S. fiscal policy will become more restrictive in 1988 as a result of efforts to narrow the federal budgetary gap. The recent accord between the Congress and the Administration is expected to lower the federal budget deficit by an estimated $30 billion in fiscal 1988 and $46 billion in fiscal 1989.

Moderate growth should continue in 1988, reflecting the stimulative impact of the improving real trade balance and lower interest rates. Real GNP should post a 2.6 per cent gain in 1987, moderating to 2.3 per cent in 1988.

Since 1980, U.S. economic policies have resulted in both large and persistent federal budget and international payments deficits. As shown in the accompanying graph, large-scale American deficits have been balanced by surpluses in West Germany and Japan. The result has strained the world trading system leading to dramatic increases in U.S. international indebtedness and highly volatile international exchange rates.

CURRENT-ACCOUNT IMBALANCES
(As Per Cent of GNP)



* Forecast
Source: O.E.C.D.

The current account deficit may result in an even further depreciation of the U.S. dollar in relation to the yen and the deutschemark. This emphasizes the need for additional efforts to harmonize monetary and fiscal policies. The United States has called for West Germany and Japan to stimulate their economies. Other countries point to the destabilizing effects of the U.S. budget deficit and the need to reduce that deficit.

Moderate growth is projected to occur in the other major industrial countries. For 1988, the OECD forecasts that Japan's real GDP will grow by 2.0 per cent. The West German and U.K. economies will expand by 2.0 per cent and 2.3 per cent respectively. Continued expansion of the world economy will be essential for resolving major international imbalances, including the U.S. trade deficit and third-world debt.

Next June's G-7 meeting in Toronto will provide a further opportunity to consider coordinated international measures to address these economic imbalances.

Rest of Canada

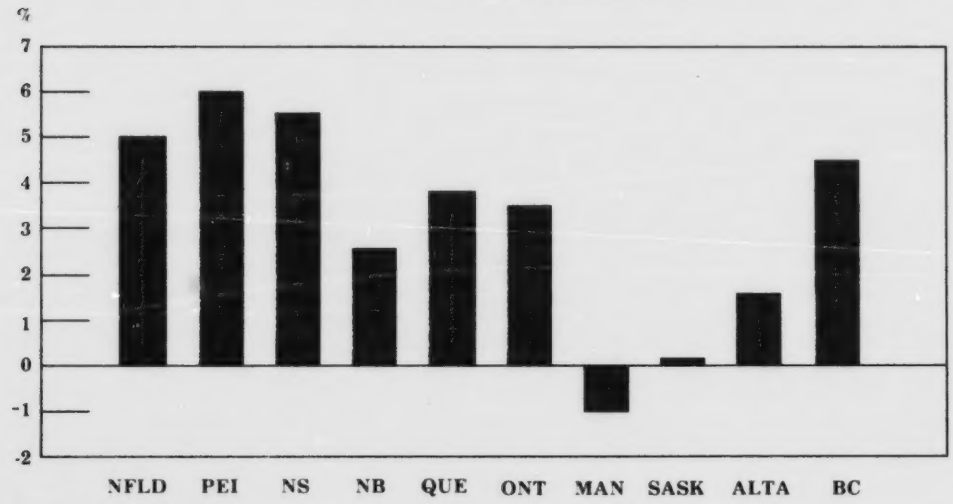
The economic performance of the other provinces has an important bearing on the Ontario outlook. Interprovincial exports of goods and services account for approximately 16 per cent of Ontario's Gross Domestic Product.

The Canadian economy has rebounded sharply from its flat performance over the last half of 1986. Growth in the first half of 1987 was supported by strong gains in consumer and business spending and in residential construction.

While Ontario and Quebec have made a major contribution to national growth this year, there is increasing evidence that the current expansion has broadened beyond Central Canada. A key factor in the surging pace of national economic growth has been a recovery of commodity prices, particularly for metals and forest products. As a result, the outlook for the resource-sensitive economies of Eastern and Western Canada has become more favourable.

- The momentum achieved during the first half of 1987 will sustain the expansion over the balance of the year and in 1988. Real GDP in Canada will advance 3.6 per cent this year and 2.5 per cent in 1988.

PROVINCIAL EMPLOYMENT GROWTH
(OCTOBER 1987 / DECEMBER 1986)



Source: Statistics Canada

The marked turnaround in Canada's economic performance in 1987 is reflected in a steady improvement in the unemployment rate. Canada's unemployment rate has declined from a seasonally-adjusted rate of 9.7 per cent in January to 8.4 per cent in October, the lowest rate since 1981. The seasonally adjusted unemployment rate for the rest of Canada has fallen sharply from 11.6 per cent in January to 10.1 per cent in October.

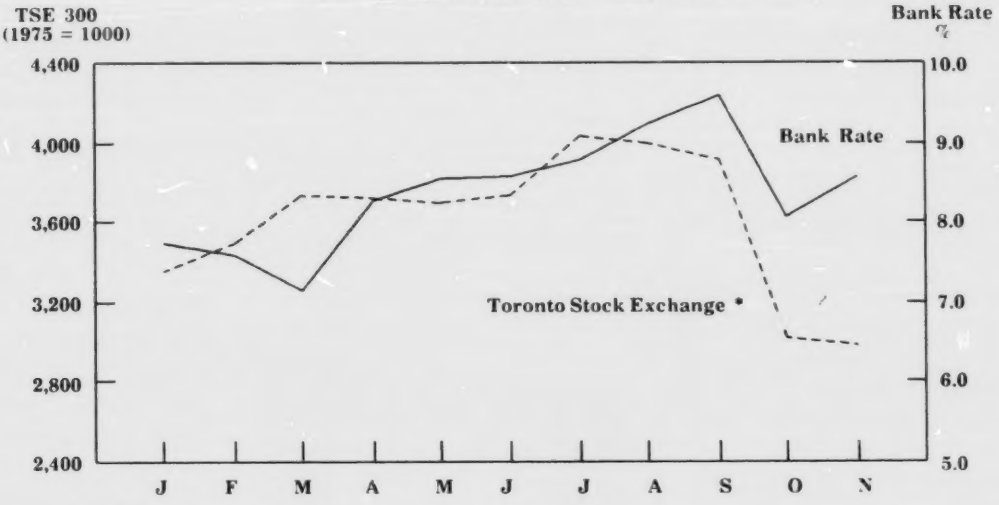
- On an average annual basis, Canada's unemployment rate should decline from 9.0 per cent in 1987 to 8.7 per cent in 1988.

Financial Markets

Central bank policy prior to the stock market downturn had been targetted toward arresting inflationary pressures in the economy. The upward trend in the Bank rate between April and September, in the face of a strengthening Canada-U.S. exchange rate, signalled a shift in the focus of monetary policy from exchange rate stabilization to moderating domestic inflation.

However, the October downturn in world stock markets has led to a sudden decline in interest rates. The sharp 157 basis point reduction in the Bank rate was a timely response by the Bank of Canada to inject liquidity into the financial system to avoid major financial failures potentially created by plunging share values.

TSE 300 and BANK RATE, 1987



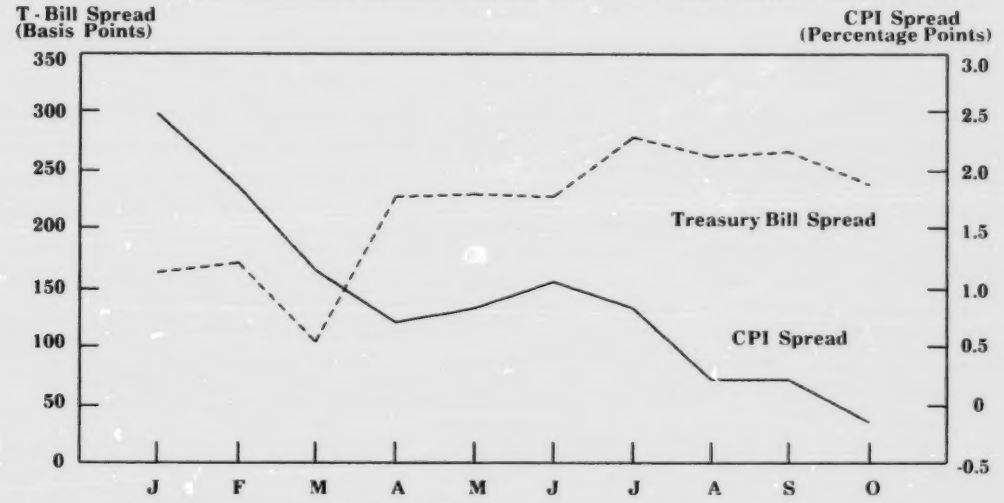
* End of Month.
Source: Bank of Canada.

The recent collapse in stock values and the reduced abilities of firms to raise equity financing will have a negative impact on both consumer and business spending. For example, the market crash has led to a roughly $70 billion reduction in household wealth in Canada. The effect of this may be to raise savings rates as households attempt to restore gradually their wealth. This lowers current consumption. Some estimates suggest that for every dollar of reduction in wealth, consumer spending is reduced by 4 to 5 cents. This would imply a reduction of consumption of between $2.8 billion and $3.5 billion in Canada. There is an additional negative effect of an increase in economic uncertainty on consumer confidence.

While these factors will moderate growth, the underlying momentum of the economy is considerable. (These issues are discussed further in Sources of Growth, pages 9-13.) Moreover, the general economic effects of the drop in stock prices have been counter-balanced by interest rate and exchange rate declines.

As the expansion continues in the Canadian economy, inflation will remain a concern for monetary policy. With the Canadian inflation rate remaining high, Treasury Bill interest rates are expected to rise around 100-200 basis points from current levels. The prime lending rate could return to its pre-October level by the middle of 1988 and rise marginally over the balance of the year.

CANADA - U.S. INTEREST RATE AND CPI DIFFERENTIAL, 1987



Source: U.S. Department of Labour, Statistics Canada, Bank of Canada and Ontario Ministry of Treasury and Economics.

A wide Canada-U.S. interest rate spread, averaging near 200 basis points, and further improvement in commodity prices will support the Canadian dollar in the 75-77 cents U.S. range during 1988. Despite its relative strength against the U.S. currency, the Canadian dollar will continue to depreciate against most major overseas currencies throughout 1988.

Energy Prices

Ontario's import bill for oil and natural gas is expected to be $7.0 billion in 1987, a modest increase from 1986. The price of oil delivered to Ontario refiners is expected to average about $19 U.S. per barrel this year.

Uncertainty in world oil markets is expected to continue through 1988. The primary sources of instability are the Persian Gulf war and continued pressures on OPEC members to exceed current production guidelines. On balance, delivered oil prices should remain in the $19 U.S. per barrel range in 1988.

- The supply of crude oil will remain fairly constant, as both OPEC and non-OPEC producers will avoid major changes to existing production levels.
- While the major industrial economies will continue to grow, the associated growth in crude oil demand will be modest and will not have a major influence on crude prices.

Sources of Growth: 1987-1988

Forecast Overview

Domestic demand will remain the primary source of economic growth in the province in 1988. Nevertheless, growth in demand will weaken, most notably in consumer spending and housing. Investment growth is also expected to moderate, especially manufacturing investment. Overall, however, investment spending should remain a source of strength in the economy. The trade sector, which exerted a major drag on the economy in 1987, will show a small improvement.

Consumer Demand

Robust growth in personal income and a decline in the savings rate to a 15-year low have fuelled strong consumer spending throughout 1987. Consumption is expected to play a less prominent role in economic growth in 1988. An increase in the personal savings rate and slower employment growth will lead to more modest growth in personal expenditures.

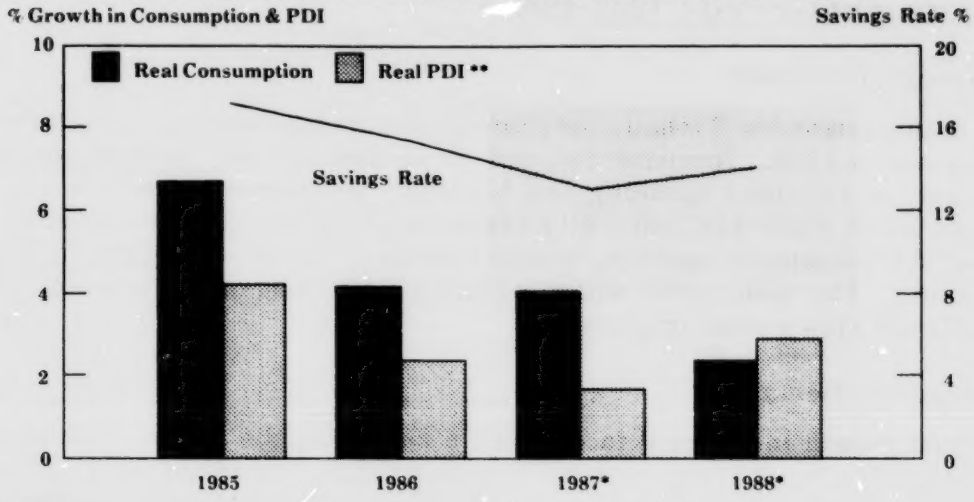
- Growth in real consumption is forecast to decelerate from 4.1 per cent in 1987 to 2.4 per cent in 1988.

GROWTH IN REAL ONTARIO CONSUMER EXPENDITURE BY TYPE

* First two quarters of 1987 only.
Source: Ontario Ministry of Treasury and Economics.

Spending on services will outpace expenditures on goods. Demand for consumer durables is expected to grow more slowly in 1988, after posting strong growth in 1986 and 1987. Much of the recent strength in durables has been related to the housing boom which is expected to taper off in 1988.

GROWTH IN REAL CONSUMPTION AND SAVINGS RATE



* Forecast
** Personal Disposable Income
Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

Over the last several years, consumer spending increases have outpaced income growth, driving down the personal savings rate. The savings rate is expected to rise in 1988 as consumers adopt a more cautious spending stance.

- Some households suffered a reduction in their net wealth as a result of the stock market crash and will shave their spending in 1988. However, the impact on consumer spending in Ontario should be less than the impact in the United States, as a somewhat smaller percentage of wealth in this country is held in the form of corporate equity.
- The impact of the stock market crash on employment and income in the financial services industry could have a more pronounced effect on Toronto because of the industry concentration in that city.
- The expected rise in interest rates will encourage a higher personal savings rate in 1988.
- Personal income growth is expected to slow marginally from 7.7 per cent in 1987 to 7.4 per cent in 1988.

Retail sales growth will moderate in line with slower growth in real consumption. Current dollar retail sales are expected to increase by 7.8 per cent in 1988, following an estimated 9.7 per cent gain in 1987.

Housing Investment

Residential investment is expected to continue at a high level in 1988. However, housing starts will be sharply down from 97,000 to 73,000.

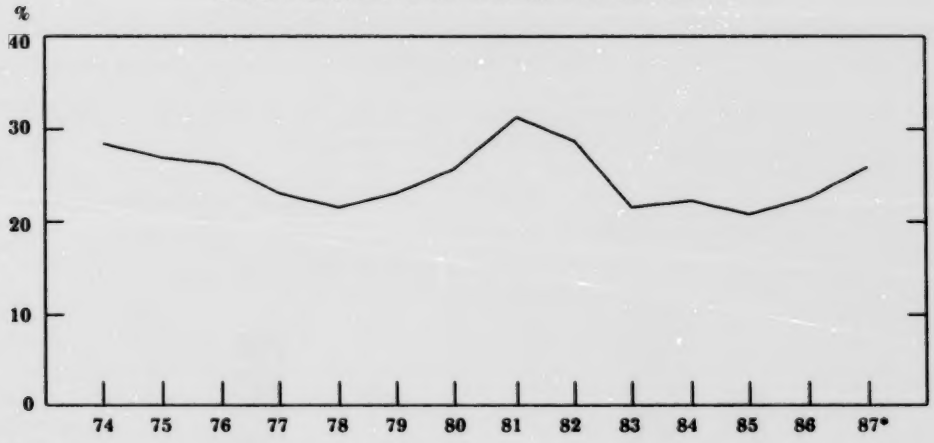
Ontario has experienced two years of very strong growth with residential investment expenditures increasing by 33.5 per cent in 1986 and by an estimated 29.7 per cent in 1987. Residential investment spending is forecast to rise by 9.7 per cent in 1988 as housing starts decline to a more sustainable

level. Renovation activity will account for an increasing proportion of investment in residential construction as households increasingly upgrade their housing stock.

A sharp rise in housing prices over the last two years and the attendant deterioration in affordability are typical of the later phase of a housing boom. Similar developments occurred near the end of the 1974 and 1981 construction booms.

- Average resale housing prices in Ontario increased by 25 per cent in 1986 and by an additional 24 per cent over the first three quarters of 1987.
- Housing affordability has deteriorated and will dampen demand. A common barometer of affordability is the ratio of mortgage payments on newly acquired homes to gross family income. A steady rise in this ratio during the previous two housing booms contributed to an eventual slowdown in housing activity. During the current boom, carrying costs as a percentage of gross family income have risen substantially, from 20.6 per cent in 1985 to an estimated 25.9 per cent in 1987.

ONTARIO MORTGAGE PAYMENTS AS A PER CENT OF FAMILY INCOME



* Estimate
Note: Mortgages on newly acquired homes.
Source: Canadian Real Estate Association, Statistics Canada and the Bank of Canada.

- A steep rise in down payments has also contributed to a deterioration in housing affordability. Assuming a standard down payment of 25 per cent, the minimum outlay for purchasing a home in Ontario has risen from 51.6 per cent of average family income in 1985 to an estimated 69.7 per cent in 1987.

Business Investment

Business investment in plant and equipment has been very strong in Ontario in 1987. Further gains are expected in 1988, although at a slower rate. These expected gains are the result of strong corporate profits, high rates of capacity utilization and continued sales growth.

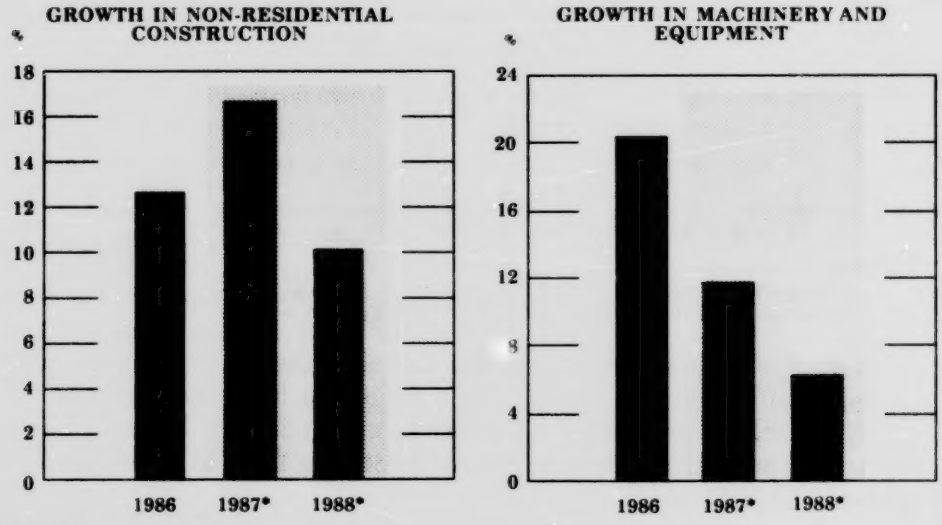
Ontario's corporate profits are expected to grow by almost 17 per cent in 1987 and 12.4 per cent in 1988. Robust growth in the Canadian economy, strengthening commodity prices and continued cost-cutting measures have all been contributing factors.

Steady increases in industrial production have boosted capacity utilization rates, which have risen substantially since the recession of 1981-82. Further increases in sales will spur more investment as businesses try to avoid production bottlenecks.

- The overall capacity utilization rate for total non-farm goods-producing industries has climbed from a low of 69.5 per cent in the last quarter of 1982 to 86.6 per cent in the second quarter of this year.
- Such diverse manufacturers as the textile, paper, furniture, and non-metallic mineral industries are experiencing capacity utilization rates in excess of 90 per cent.

Total business investment is forecast to increase from $25.9 billion in 1987 to $27.9 billion in 1988.

- Non-residential construction is expected to grow by 10.2 per cent in 1988, following a 16.7 per cent increase in 1987.
- Machinery and equipment spending will rise by 6.3 per cent in 1988, after an 11.8 per cent increase this year.
- Investment spending will be strongest in the retail and wholesale trade and commercial services sectors of the economy.



* Forecast

Source: Ontario Ministry of Treasury and Economics.

External Trade

In 1987, the trade sector has been a major source of weakness in the economy, partially offsetting the strength in domestic demand. While imports have been maintained by strong consumer and business spending,

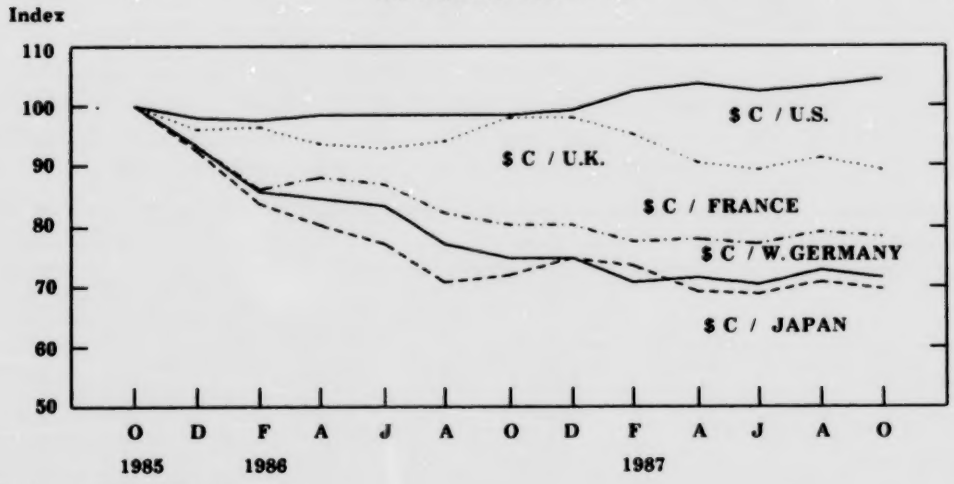
export growth weakened noticeably as a result of falling auto exports. The decline in auto exports reflects a sluggish U.S. auto market and lengthy shutdowns in some Ontario auto plants for conversion to new models.

- In nominal terms, exports are estimated to grow by less than one per cent this year, down sharply from 5.4 per cent last year.
- Over the first eight months of the year, auto exports were down 7.8 per cent from last year's pace. Total merchandise exports to the U.S. have declined by 5.2 per cent over the same period.
- Merchandise exports to other countries have risen by 12.5 per cent over the first eight months of the year.
- Imports are estimated to have grown by 2.1 per cent in 1987, compared to growth of 7.8 per cent last year.

Exports to the United States will rise in 1988, although the increase will be limited by weak growth in that country's economy. The depreciation of the Canadian dollar against most major world currencies will have a favourable effect on trade with other countries. Recent improvements in economic performance in Western Canada and the Atlantic provinces will provide a stimulus to Ontario's interprovincial exports.

- Since September 1985, the Canadian dollar has depreciated by 36.4 per cent against the yen, 33.5 per cent against the mark, 27.1 per cent against the franc, and 14 per cent against the pound.

CANADIAN DOLLAR EXCHANGE RATES OF MAJOR CURRENCIES
OCTOBER 1985 = 100



Source: Bank of Canada.

Ontario's overall trade balance, including international and interprovincial trade, is expected to improve slightly in 1988 as nominal exports and imports grow at about the same pace.

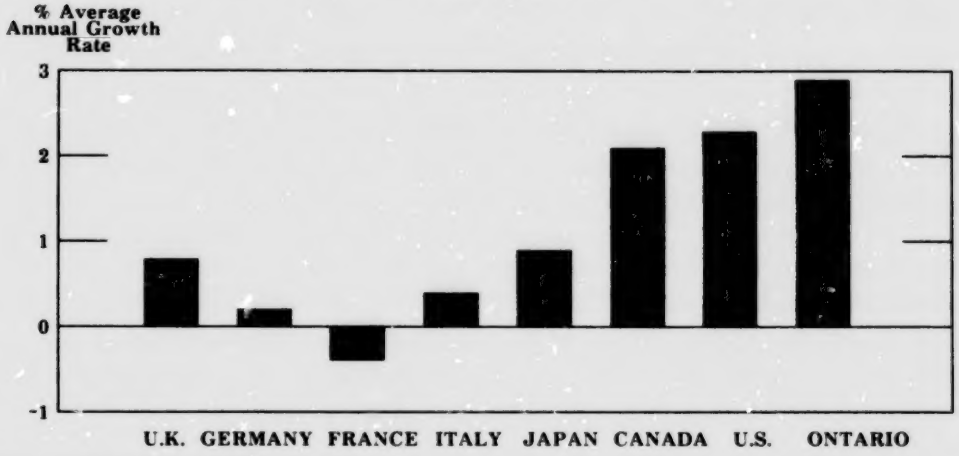
- Exports will increase by $5.1 billion to $110.7 billion in 1988.
- Imports are forecast to reach $100.5 billion in 1988, up $4.6 billion from the level in 1987.

Labour Markets

Introduction

From 1982 to 1987, Ontario's employment grew by over 630,000 people – an average annual growth rate of almost three per cent. This was a higher rate of growth than was achieved by any of the seven major industrial countries in the world.

INTERNATIONAL COMPARISON OF EMPLOYMENT GROWTH
1982 - 1987



Source: O.E.C.D. and Statistics Canada.

Forecast Overview

The Ontario labour market is expected to continue to improve next year. Employment is forecast to increase by 105,000. This is down from an average of 146,000 new jobs this year. The unemployment rate is expected to average 5.8 per cent in 1988, down from a 6.2 per cent average in 1987.

Ontario Labour Market Outlook **Table 1**

	1986	1987 (000s)	1988	86/85	87/86	88/87 (percentage growth)
Labour Force	4,897	5,011	5,104	2.3	2.3	1.9
Employment	4,555	4,701	4,806	3.5	3.2	2.2
Job Creation	153	146	105	-	-	-
Unemployment	342	310	298	-	-	-
Unemployment Rate (%)	7.0	6.2	5.8	-	-	-
Participation Rate (%)	68.5	68.8	69.1	-	-	-

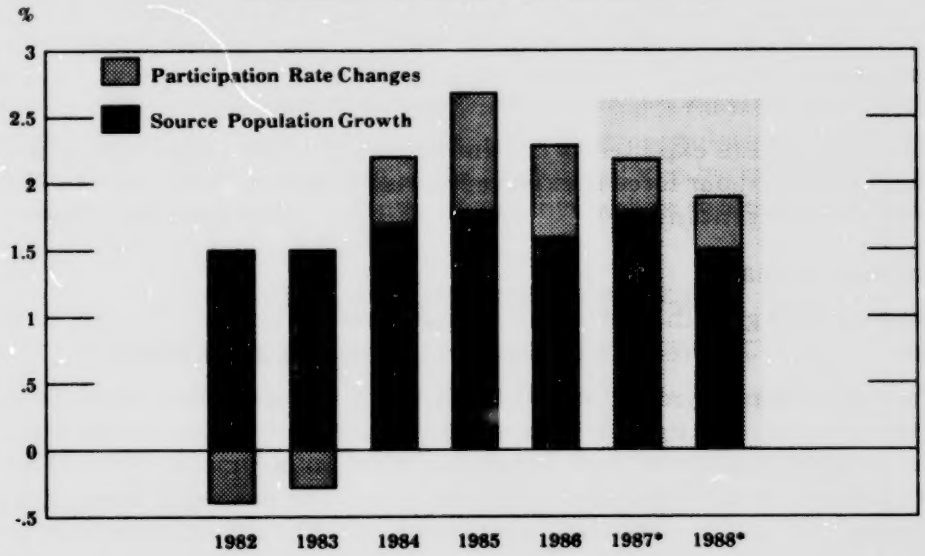
Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

Labour Supply

Ontario's labour force will increase by 2.3 per cent this year and is forecast to slow to 1.9 per cent growth in 1988. Source population growth accounts for 80 per cent of the increase with participation rate increases accounting for the remainder.

After reaching about 40,000 in 1986, net interprovincial migration is expected to moderate as growth in the Canadian economy becomes more regionally balanced. International migration, however, is expected to be higher than in the past few years. Overall, net migration to Ontario should add over 30,000 persons to the Ontario labour force in 1988.

ONTARIO LABOUR FORCE GROWTH

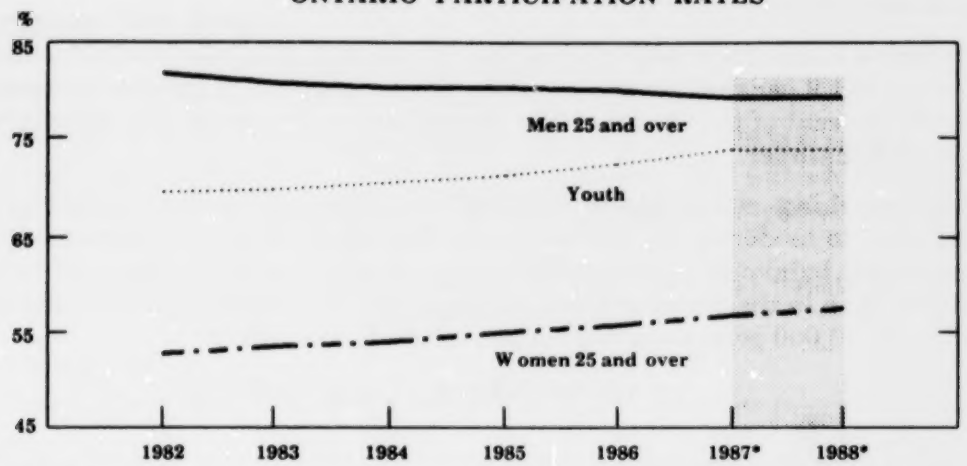


* Forecast
Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

Ontario's aggregate participation rate has risen continuously since 1983. The rise is accounted for by large increases in the participation of young people and adult women, partially offset by a decline in the participation of adult men.

- Youth labour force participation rates increased by more than four percentage points between 1982 and 1987. The gain was almost entirely the result of increased part-time participation by full-time students.
- The participation rate of women aged 25 and over rose from 52.6 per cent in 1982 to over 56 per cent in 1987. Women with children less than six years of age accounted for most of the increase.
- The participation rate of adult men dropped about two percentage points between 1982 and 1987 due to a decline in older workers' labour force participation. The participation rate of men aged 55 to 64 fell from 78.6 per cent in 1982 to about 70 per cent in 1987.

ONTARIO PARTICIPATION RATES



* Forecast
Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

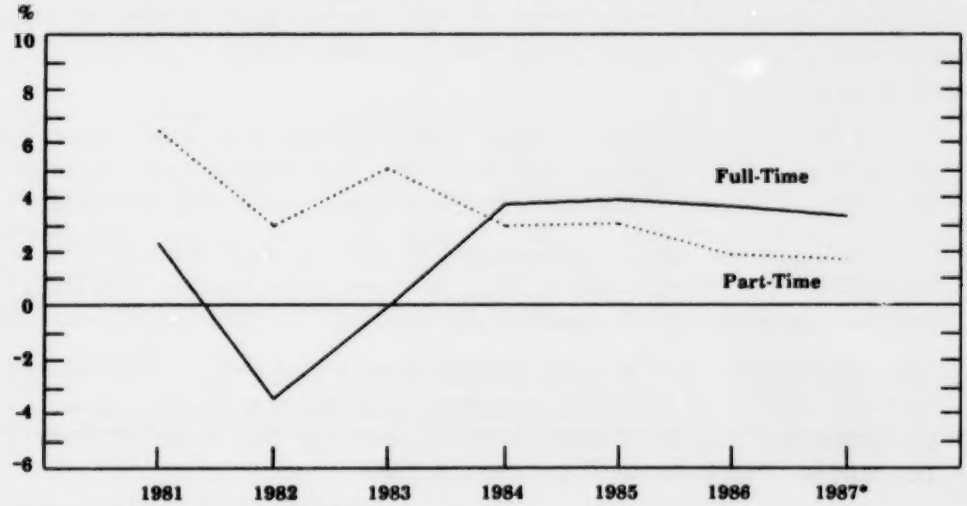
These trends are expected to continue through 1988. As a result, women's share of the labour force is expected to rise to about 45 per cent in 1988, up from 41.8 per cent in 1980.

Labour Demand

Employment growth is expected to slow from 3.2 per cent in 1987 to 2.2 per cent in 1988. Job creation will moderate from 146,000 to 105,000.

Part-time employment in Ontario grew much faster than full-time employment during the recession. However, since 1984 full-time employment has grown faster than part-time employment. Since 1982, over 80 per cent of the jobs created in Ontario have been full time, mostly in managerial and professional occupations. Of the 139,000 new jobs created in the first ten months of this year, 78,000 were managerial and professional positions and 38,000 were service, sales and clerical positions.

ONTARIO FULL-TIME AND PART-TIME EMPLOYMENT GROWTH



* Includes January to October 1987 only.
Source: Statistics Canada.

Full-time employment will continue to grow at a faster pace than part-time employment in 1988. Part-time work is expected to account for about 15 per cent of employment in 1988.

The private sector, which created over 85 per cent of the new jobs between 1982 and 1987, will continue to dominate job creation in 1988. Within the private sector, the rapid growth in self-employment peaked in 1985; self-employment in 1985 was 13 per cent of total employment. Since 1985, this growth has slowed and is expected to remain moderate in 1988.

Unemployment

The unemployment rate is forecast to average 5.8 per cent in 1988. This would be the lowest rate since 1974.

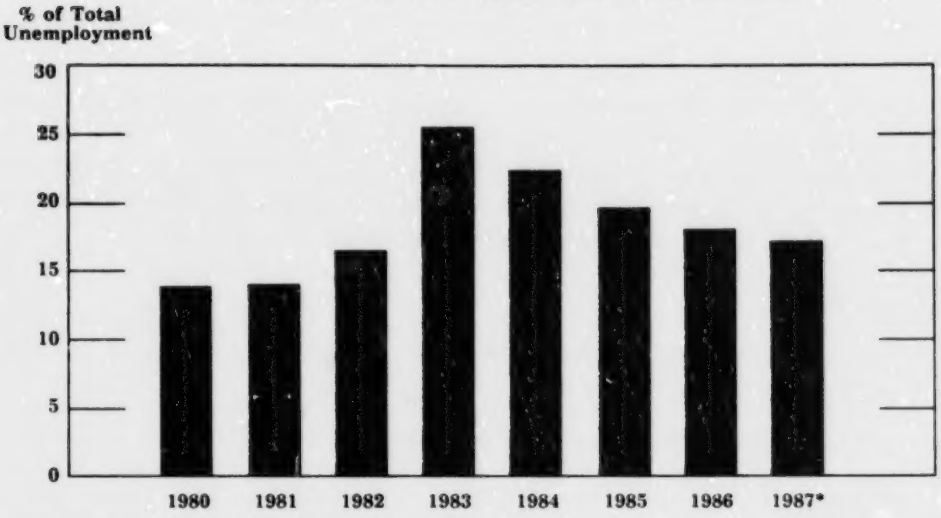
Ontario's youth unemployment rate averaged close to 10 per cent in 1987, down from 17.8 per cent in 1983. The youth share of total unemployment has fallen from a peak of 46.8 per cent in 1981 to less than 35 per cent in 1987. This largely reflects the decrease in the youth population. There has also been a significant narrowing in the traditional gap between youth and adult unemployment rates. Youth unemployment is forecast to decline further in 1988.

ONTARIO YOUTH UNEMPLOYMENT

* Includes January to October 1987 only.
Source: Statistics Canada.

In spite of the overall strength of Ontario's labour market, the number of long-term unemployed is still significantly higher than at the beginning of the decade. In the first ten months of 1987, workers who were unemployed for more than six months represented 17.2 per cent of total unemployment, compared to 13.8 per cent in 1980.

ONTARIO LONG-TERM UNEMPLOYMENT



* Includes January to October 1987 only.
Source: Statistics Canada.

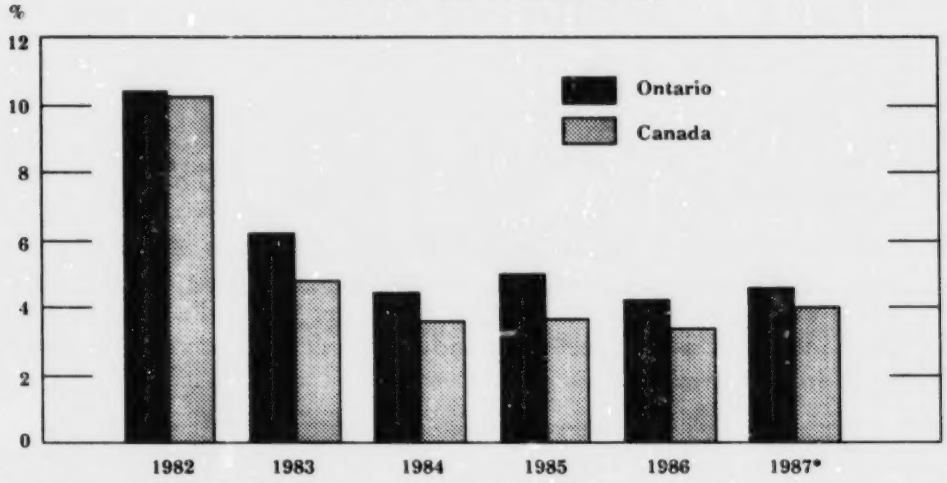
Wage Settlements

Real earnings per worker are expected to show little growth in 1988. This is despite tighter labour markets, particularly in the Metropolitan Toronto area.

Through the first three quarters of 1987, Ontario wage settlements, while above 1986 levels, have remained moderate. Ontario settlements still exceed settlements at the national level.

- In Ontario, collective bargaining settlements averaged 4.3 per cent in 1986. In the first three quarters of 1987, they averaged 4.6 per cent.
- Wage gains for Canada have been lower than wage gains in Ontario due to Ontario's tighter labour markets. Settlements in 1986 averaged 3.4 per cent across Canada. In the first three quarters of 1987, Canadian settlements increased by an average of four per cent.
- Private sector wage settlements have generally been below public sector settlements. In the first three quarters of 1987, Canadian settlements in the private and public sectors averaged 3.4 per cent and 4.1 per cent, respectively. In Ontario, settlements averaged 4.3 per cent for the private sector and 4.8 per cent for the public sector during the same period.

WAGE SETTLEMENTS
(OVER 500 EMPLOYEES)



* Includes January to September only.
Source: Labour Canada.

Ontario wage settlements are expected to increase roughly in line with inflation next year.

Non-Wage Compensation

Non-wage compensation is an increasingly significant component of total compensation. Included in non-wage compensation are wage-related costs such as holidays, vacations and paid leave, as well as costs associated with health, pension, and other benefits. Mandatory employer payments for unemployment insurance premiums, CPP contributions, and workers' compensation are also important labour cost items.

Although total non-wage compensation is difficult to measure, the evidence suggests that it is growing faster than total labour income. For example, mandatory employer payments, contributions to private pensions, and health benefits have risen steadily as a proportion of labour income in Ontario. They reached 9.5 per cent in the first half of 1987 compared to 8.6 per cent in 1982. This trend is expected to continue.

Inflation

Canada

The past year has seen a gradual increase in inflation. Consumer price inflation in Canada was running at 4.4 per cent for the first ten months of 1987, up from the 1986 average of 4.1 per cent. Canada's consumer price inflation is expected to rise by 4.6 per cent in 1988, up from 4.4 per cent this year.

Several factors will lead to slightly higher inflation next year.

- Higher U.S. inflation and the depreciation of the Canadian dollar against most major overseas currencies will put upward pressure on import prices.
- Oil prices have stabilized after a sharp decline in 1986 and will no longer have a deflationary impact. The price of oil delivered to Ontario is expected to remain around $19.00 U.S. per barrel.
- Other raw material prices are rising. Non-ferrous metal prices have risen by 9.9 per cent in the ten-month period ending in October 1987, while wood product prices were up 10.6 per cent. Further commodity price increases are expected as industrial demand continues to reduce world inventories.
- The broadening of the current expansion to the more resource-dependent provinces is resulting in tighter national labour markets. This will contribute to higher wage gains.
- Rate changes and base broadening of federal sales taxes scheduled to take effect on January 1, 1988 will put upward pressure on the Canadian CPI inflation rate.

The gap between the Canada and U.S. CPI inflation rates has narrowed steadily over the course of the year. In October, Canada's CPI inflation fell below the U.S. rate for the first time since December 1984. Canada's inflation rate is expected to be marginally higher than the U.S. rate in 1988.

Ontario

Since 1983, Ontario's consumer price inflation has been above the national rate. This trend has continued over the first ten months of this year, largely as a result of more rapid increases in housing prices. Ontario consumer price inflation is expected to average 5.1 per cent this year.

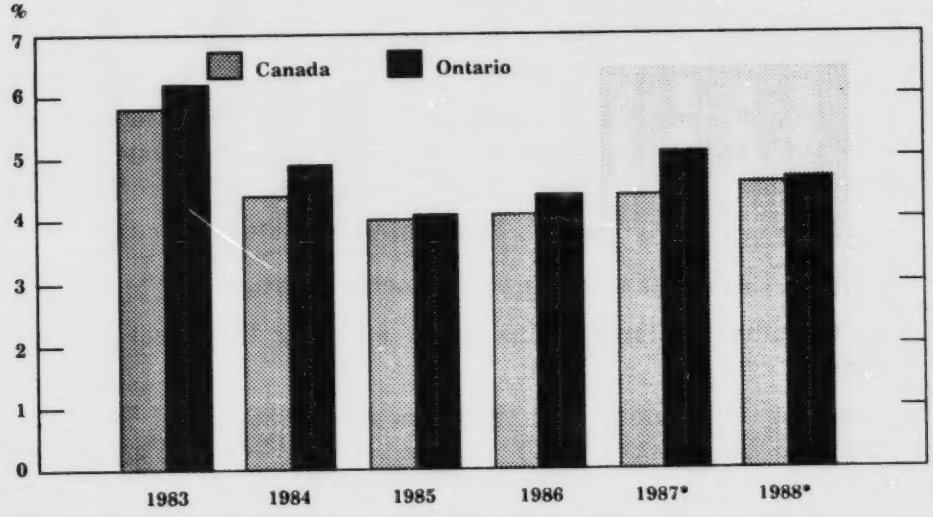
As house price increases moderate next year, Ontario's consumer price inflation will closely track the national rate. Ontario consumer prices are expected to increase by 4.7 per cent in 1988.

- Driven by a sharp rise in the cost of owner accommodation, the housing component of Ontario consumer prices rose by 5.6 per cent over the first ten months of the year, compared to a 3.9 per cent increase in Canada. The rise in housing costs accounted for 42 per cent of the overall increase in Ontario consumer price inflation and 89 per cent of the difference with Canada.
- Tighter labour markets have contributed to higher wage gains in Ontario relative to Canada.

Within Ontario, there is a considerable divergence in inflation between different cities. Inflation has been highest in Toronto, largely as a result of more rapid increases in house prices.

- The Toronto Consumer Price Index rose by 5.8 per cent over the first ten months of 1987. The housing price index rose by 7.1 per cent and accounted for 47 per cent of the increase in the Toronto Consumer Price Index. The stock market crash may have a dampening effect in 1988.
- Ottawa and Thunder Bay had much lower rates of overall inflation, at 4.0 and 3.2 per cent respectively. The housing component rose by only 3.0 per cent in Ottawa and by 1.5 per cent in Thunder Bay.

CANADA AND ONTARIO CPI INFLATION



* Forecast
Source: Statistics Canada and the Ontario Ministry of Treasury and Economics.

Medium-Term Outlook and Issues: 1989-1991

The medium-term outlook provides a projection of the performance of the Ontario economy during the 1989-1991 period. It is important to note that these projections do not necessarily imply targets for the economy; nor are they to be regarded as necessarily an acceptable economic performance.

Forecast Overview

There are several key assumptions that underlie the base case projection.

- The U.S. slows significantly in 1989, but not sufficiently to push the Canadian economy into recession.
- Steady improvement in the U.S. budgetary and trade deficits, coupled with stimulative policies in West Germany and Japan, sustain the global expansion.
- Wage and price inflation is contained to around five per cent.
- Energy prices increase in line with general inflation.
- The Canadian dollar remains below 80 cents U.S. over the forecast period.

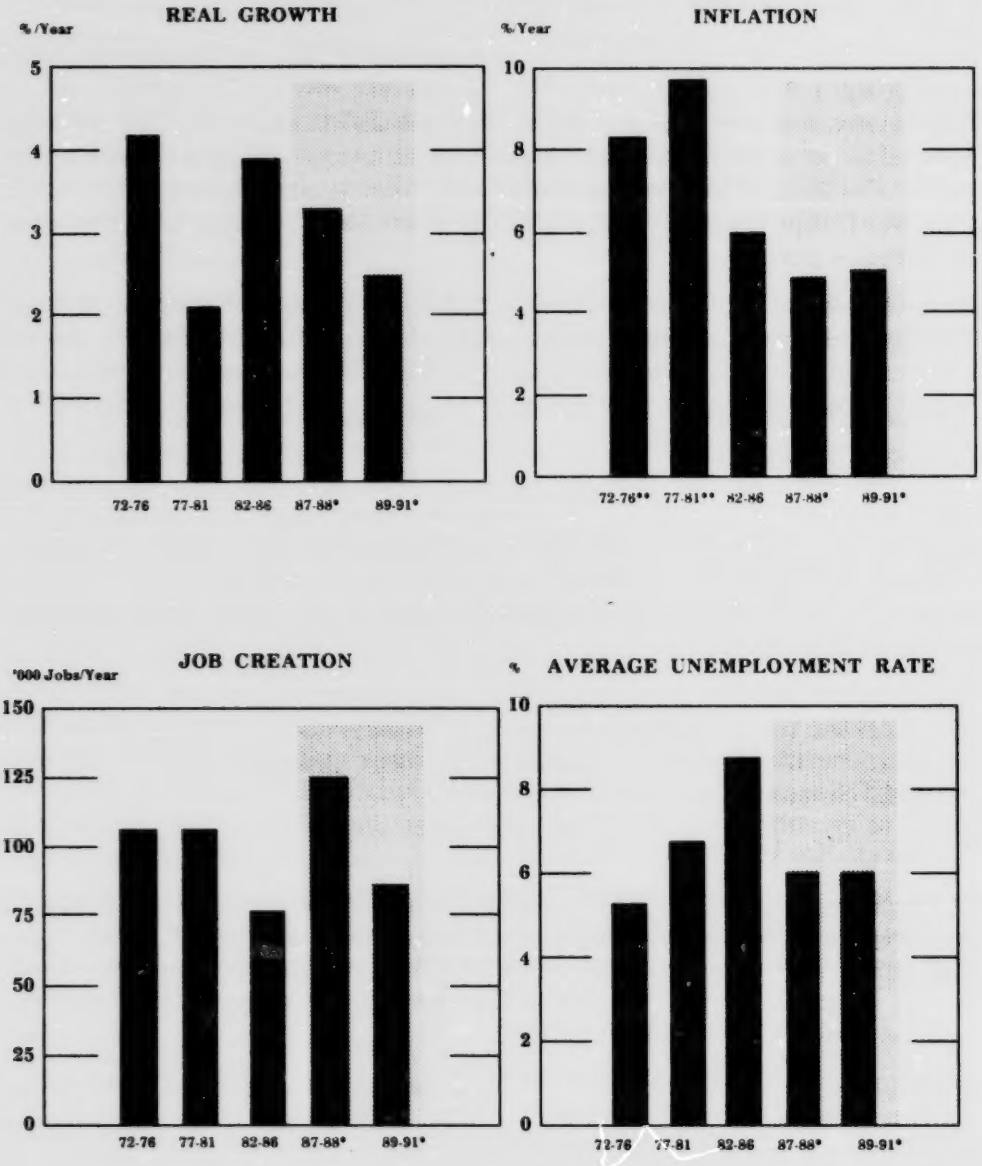
The following table summarizes the forecast for 1989-1991. The forecast is for continued, but slower growth over the period. Economic growth is weak in 1989, followed by stronger growth in subsequent years. The average is 2.5 per cent per annum for the period. The accompanying graphs compare this forecast performance with preceding periods.

The Ontario Economy: 1989-1991 **Table 2**
(Annual Average)

	Base Case
Real Growth (%)	2.5
Inflation (%)	5.0
Job Creation (000s)	87
Unemployment Rate in 1991 (%)	5.6

Source: Ontario Ministry of Treasury and Economics.

ONTARIO'S MEDIUM-TERM OUTLOOK



*** Forecast**

**** Canadian inflation as pre-1980 data for Ontario are not available.**

Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

Key Factors

U.S. Economy and World Economy

Over the forecast period, the U.S. is projected to achieve moderate growth averaging 1.9 per cent annually. Joint efforts by Congress and the Administration to reduce the federal budget deficit cause the U.S. economic expansion to slow sharply in 1989. The economy recovers in subsequent years. The large depreciation of the U.S. dollar since 1985 sets the stage for a gradual improvement in the trade balance that is sustained throughout the forecast period.

Modestly stimulative fiscal action is taken in Western Europe and Japan. This partially compensates for fiscal restraint in the United States. As well, a favourable Canadian dollar exchange rate in overseas currencies provides export opportunities in other foreign markets as well as in the U.S. market.

Canadian Economy

The Canadian economy will continue to expand over the medium term, growing at a 2.4 per cent average annual rate over the period. Steady, but modest, increases in commodity prices will benefit the resource-based economies of Western and Eastern Canada, resulting in more regionally balanced growth.

The forecast assumes implementation of stage I of tax reform. The planned reform of the tax system will have a modest stimulative impact on economic growth, mainly through the effect of lower personal income taxes on personal consumption.

Financial Markets

Interest rates peak in 1989 as inflation drifts up over five per cent. A moderating inflation rate permits some softening in interest rates in 1990 and 1991. The Canadian dollar benefits from an improvement in Canada's terms of trade and from wide Canada-U.S. interest rate spreads, appreciating to 79 cents U.S. by 1991.

Oil Prices

Oil prices are expected to be relatively stable in real terms over the medium term, despite the pressure of considerable uncertainties within OPEC. This will provide a positive climate for investment in petroleum exploration and development. As a result, the economies of the oil and gas producing provinces will benefit, as will Ontario's energy-supplier industries.

Sources of Growth

Business spending and exports are expected to play a leading role in economic growth over the medium term, supplanting the role of housing and consumer spending in recent years. Investment spending will be sustained by continued growth in final sales, high rates of capacity utilization and healthy gains in corporate profits.

Over the earlier phase of the current expansion, a rapid decline in the savings rate permitted real consumption to grow at a significantly quicker pace than real disposable income. The attendant run-up in consumer debt, coupled with higher interest rates over the forecast period, will reverse this trend.

Over the medium term, real consumer spending growth will lag behind income gains as the savings rate inches up from its 1987 trough. Tax reform will provide a temporary stimulus to consumer spending in 1989. However, the impact of a higher savings rate will limit growth in consumer spending in 1990 and 1991.

Slower household formation and the increased price of housing will dampen housing demand relative to the 1986-1987 boom. Housing starts are projected to average 70,000-75,000 units per year.

The trade sector will recover after 1989, with net exports playing a larger role in economic growth in 1990 and 1991. Export gains will be limited in 1989 by a weaker U.S. economy, but will pick up in the following years. Import growth will slow through the medium term, in line with more moderate gains in domestic demand.

Employment, Productivity and Inflation

Employment and Labour Force

The Ontario economy is projected to generate 87,000 jobs per year over the 1989-1991 period. Employment is expected to grow at an average annual rate of 1.8 per cent. The labour force is expected to grow at a 1.7 per cent average annual rate. The unemployment rate declines gradually to 5.6 per cent in 1991.

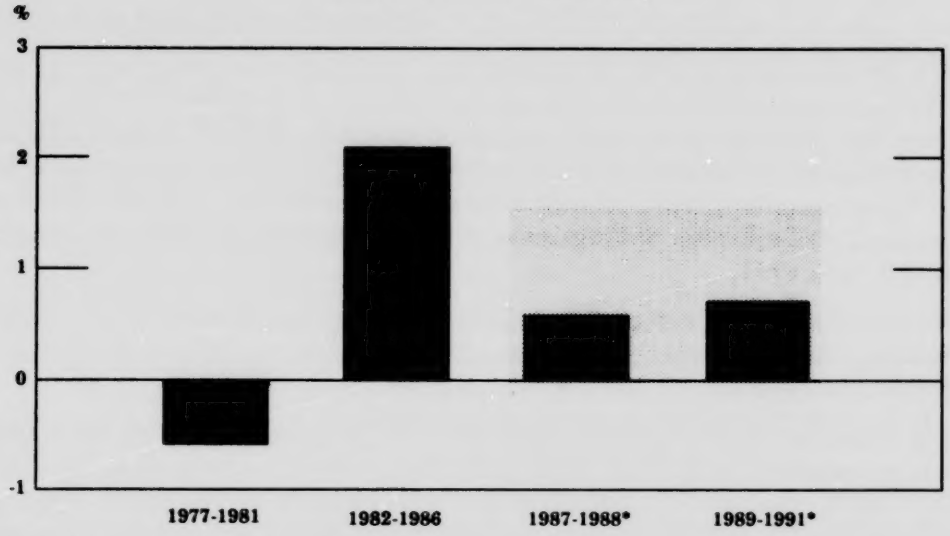
Growth of the labour force will slow over the forecast period. This reflects a slowdown in the growth of the over–15 population, only partially offset by a higher participation rate.

Productivity

Productivity growth is a crucial factor for the province's medium-term economic prospects, affecting international competitiveness, job creation and real income growth. Productivity is expected to grow at close to its current rate, following very rapid growth during the early phase of this cyclical recovery. The projected 0.7 per cent average annual increase in output per employee over the medium term compares very favourably with performance during the late 1970s. Relatively strong productivity growth over this period will be supported by:

- stable real energy prices;
- moderate inflation;
- recent strong capital formation; and
- maturing of the labour force.

ONTARIO PRODUCTIVITY PERFORMANCE
(Compound Annual Growth Rates)



*** Forecast**
Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

Inflation

Consumer price inflation is expected to average five per cent over the 1989-1991 period. Inflation peaks in 1989, partly in response to stage one increases in the federal sales tax. Following slower growth in 1989, inflation moderates in 1990 and 1991.

Alternative Scenario: Impact of a 1989 U.S. Recession

All forecasts are contingent on certain assumptions. Because Ontario has an open economy highly dependent on trade, the key assumptions for Ontario concern external factors. The base case, outlined earlier, presumes a generally supportive international economic environment, particularly with respect to the U.S. economy. This section provides an alternative medium-term projection of the Ontario economy based on a less favourable assumption about the performance of the U.S. economy.

In this scenario, U.S. domestic consumption continues to grow strongly in 1988. As a result, the U.S. trade deficit shows no improvement, leading to continued depreciation in the U.S. dollar. The falling dollar discourages foreign capital flows needed to finance U.S. trade and budget deficits. The dollar decline also adds renewed inflation concerns. The Federal Reserve Board tightens monetary policy. In 1989, fiscal policy turns restrictive in order to reduce the budget deficit. These restrictive policies lead the U.S. economy into a recession in 1989.

In this scenario, the downturn in the U.S. economy leads to no growth in the Ontario economy in 1989. Initially, the impact of a U.S. recession is felt in Ontario export sectors such as autos, resource-based commodities and

capital goods oriented to U.S. markets. Lower employment and income in the export sectors in turn weaken domestic demand.

The Ontario economy recovers in 1990, in step with a rebound in the U.S. economy. The expansion of real output and employment continues in 1991.

The 1989-1991 Ontario Economy: Alternative Scenario **Table 3**
(Annual averages)

	Base Case	Recession Case
Real Growth (%)	2.5	1.9
Inflation (%)	5.0	4.2
Job Creation (000s)	87	78
Unemployment Rate in 1991 (%)	5.6	6.0

Source: Ontario Ministry of Treasury and Economics

- Job creation falls sharply in 1989 before recovering to average 100,000 over 1990 and 1991. It averages 78,000 over the period.
- The unemployment rate rises by almost a percentage point to 6.7 per cent in 1989. The impact of weaker job creation on the unemployment rate is partially offset by slower labour force growth. A recovery in employment growth pushes the unemployment rate down to six per cent by 1991.
- Slower economic growth and higher unemployment contribute to lower inflation than in the base case. Over the 1989-1991 period, Ontario consumer prices rise at an average 4.2 per cent annual rate.

Tax Reform: Stage I

The medium-term forecast incorporates the economic impact of the first stage of tax reform announced by the federal government last June. These measures will reduce personal income tax revenues. These losses are offset by raising corporate income tax revenue and increasing federal sales tax revenues through broadening the tax base. Corporate tax rates will be reduced but the base will be broadened by a number of measures, including curtailed capital cost allowances.

The net effect of stage one of tax reform on the Ontario economy will be marginally positive. By 1991, real output is 0.3 per cent higher than would have occurred without tax reform. Consumer spending is stimulated by higher disposable income growth. Business investment spending is lower, due mainly to reduced depreciation allowances. Various sales tax increases will put upward pressure on consumer prices in the short-run, but this effect gradually diminishes.

- The simulation results in Table 4 reflect the assumption that the final reform package is as announced by the Minister of Finance in June, 1987. In this regard, Ontario has suggested changes in the proposed reforms of, amongst other things, the capital cost allowance, put-in-use

rules for capital investment and the incentives for research and development spending by some corporations.

Economic Impact on Ontario of Tax Reform, Stage One **Table 4**
(Per cent change from no Tax Reform Case)

	1988	1989	1990	1991
Real Output	0.0	0.2	0.3	0.3
Consumption	0.1	0.9	1.3	1.2
Business Investment	-0.4	-0.8	-1.0	-1.3
CPI Inflation Rate*	0.3	0.2	0.1	0.0

Source: Ontario Ministry of Treasury and Economics.
* Change in percentage points

The medium-term outlook does not incorporate the proposed second stage of tax reform which may introduce a new broadly-based national sales tax. The design and timing of changes in the second stage are yet to be determined.

Canada-U.S. Trade and Investment Agreement

A single quantitative estimate of the macroeconomic impact of the proposed Canada-U.S. trade and investment agreement is not possible. The proposed deal covers many areas and issues – for example, from tariffs to investment, to energy, to services, to procurement, to agriculture, and to dispute settlement. Most, if not all, do not lend themselves to summary arithmetic evaluations. There are issues of the balance of Canadian versus U.S. gains in the deal. Many argue that Canada has made fewer gains, and conversely faces higher costs, in the overall package of proposals. As well, in areas such as energy pricing, quantitative restrictions on exports and foreign investments, there are issues related to future flexibility to pursue regional and industrial development.

Therefore, this section is not an overall assessment of the costs or the benefits of the proposed deal. Nor does this section review the pros and cons of each element of the package. Such an analysis would be much longer than can be offered here.

This section does, however, make general references to the impacts of mutual Canada-U.S. tariff reductions and to the failure to enhance materially Canada's "security of access" to the U.S. market.

If passed into law, tariff reductions under the proposed Canada-U.S. trade agreement only begin, on a phased basis, in 1989. The relatively low average level of existing Canada-U.S. tariffs, the relatively modest amount of Canada-U.S. trade affected by tariffs, and the 10-year phased-in nature of the changes, imply that the overall impact in the forecast period to 1991 is likely to be very small in relation to the prospective growth of the economy.

The reduction of Canadian tariffs will cause dislocation in some industries, for example food processing and household appliances. Nonetheless,

marginally lower prices for imported goods should lower consumer prices and modestly increase real incomes in Canada. The effect of this is to boost aggregate demand and stimulate industry in general. Phasing out U.S. tariffs on Canadian exports may provide a slight competitive boost to some Canadian industries in U.S. markets. The net effects of mutual tariff reduction will be very small, but marginally positive. This is not to imply, however, that the tariff reduction deal on its own merits was a favourable negotiation for Canada, given the relatively higher starting point for Canadian tariffs. Any adjustment costs can be expected to be much larger, both absolutely and relatively, in Canada than in the United States. This issue has not been addressed in the principles of the proposed deal.

Any potential benefits of the overall deal would have been larger had the proposed agreement contained mechanisms which gave greater assurance against U.S. harassment of Canadian exports under the U.S. contingent protection laws. This would have given more "secure access". Also, had the proposed agreement removed the export tax on softwood lumber and provided access to U.S. defence procurement, and to state and local government procurement, economic gains would have been larger. In this case Ontario and the rest of Canada could have anticipated some increases in investment spending. Productivity growth would have been higher over the medium term. Export earnings would have increased, permitting either a stronger Canadian dollar and/or lower Canadian interest rates.

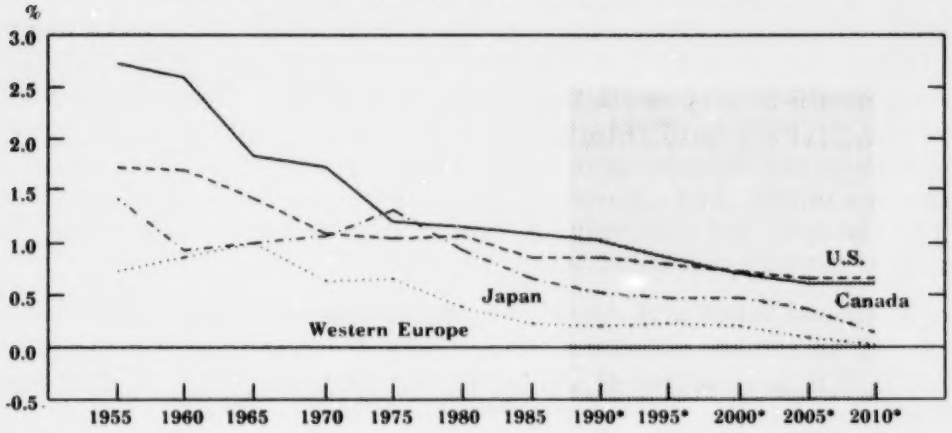
Population Growth

Population growth and age structure have a strong influence on economic growth through their impact on labour supply, labour quality and savings rates. They also have an influence on the level and composition of domestic demand.

The Ontario population is currently projected to reach 9.7 million in 1991 and 10.7 million by 2006. The average annual rate of increase between 1986 and 1991 will be just over one per cent, comparable to the average rate in the first half of the 1980s. The relative contribution of natural increase rises over the period to 1991, but then falls off considerably through the 1990s.

Details of the projection were reported in the June 1987 Demographic Bulletin. Fertility rates are assumed to fluctuate in a narrow band around their current level; mortality rates are assumed to continue their slow, gradual decline; immigration is assumed to increase in line with federal policy targets; and recent gains from net interprovincial migration are assumed to taper off to average historic levels by the early 1990's, as more balanced economic growth is achieved among the regions of Canada.

POPULATION GROWTH, SELECTED COUNTRIES **



* Forecast

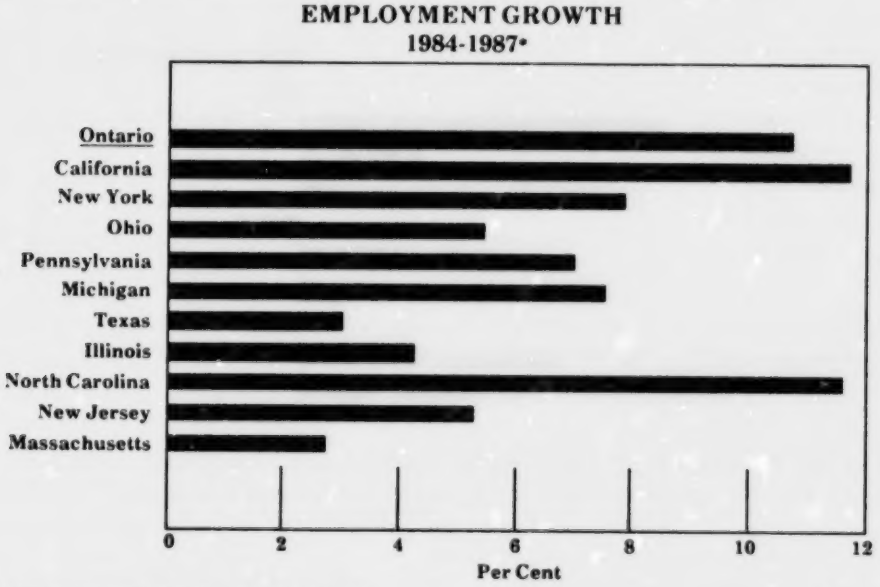
** Data points are average annual increases over five preceding years.

Source: UN World Population Prospects.

Over the next twenty years, Ontario's population growth will continue to outstrip that of most industrial countries, and of most provinces. European countries and Japan will approach zero population growth. Ontario's population is projected to grow at a 0.8 per cent average annual rate.

Large Industrial States: Comparative Performance

In recent years, Ontario has had one of the strongest economic performances among large industrial jurisdictions in North America. The largest industrial states in the United States are California, New York, Ohio, Pennsylvania, Michigan, Texas, Illinois, North Carolina, New Jersey and Massachusetts. In 1986 these ten states accounted for 55 per cent of U.S. manufacturing employment and 53 per cent of total employment.



* Based on January to October employment.
Source: Statistics Canada and D.R.I.

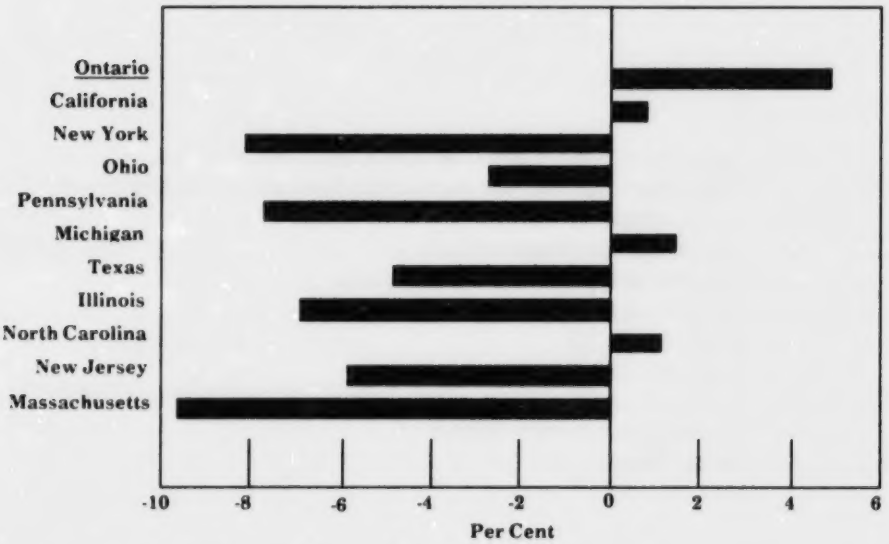
Total employment growth for the average of the ten largest U.S. industrial states from 1984 to 1987 (January-October) was 7.1 per cent. The comparable rate for Ontario was 10.8 per cent. On an individual basis, Ontario's total rate of job creation was surpassed by only two of the ten major industrial states.

- Employment rose by 11.7 per cent in California and 11.6 per cent in North Carolina over the same period.
- The employment level rose by only 3.0 per cent in Texas, reflecting the energy downturn. Massachusetts experienced only a 2.7 per cent gain in jobs, despite higher levels of defence spending and an expanding high technology base.

Manufacturing enterprises employ over one million Ontario residents. Over 90 per cent of Ontario's exports in 1986 were produced by manufacturing enterprises. Therefore, strong performance in this sector has a large impact on the general performance of the Ontario economy. Comparative data on manufacturing employment growth reveal a strong relative performance in Ontario. Ontario manufacturing employment growth has exceeded that of every major industrial state in the United States.

- Manufacturing employment in Ontario expanded by 4.9 per cent between 1984 and 1987 (January-September). Persons employed in manufacturing fell by an average 3.8 per cent in the ten largest U.S. industrial states over the same period, reflecting a net loss of 410,000 jobs.

MANUFACTURING EMPLOYMENT GROWTH*
1984-1987



* Based on January to September employment.
Source: Statistics Canada and D.R.I.

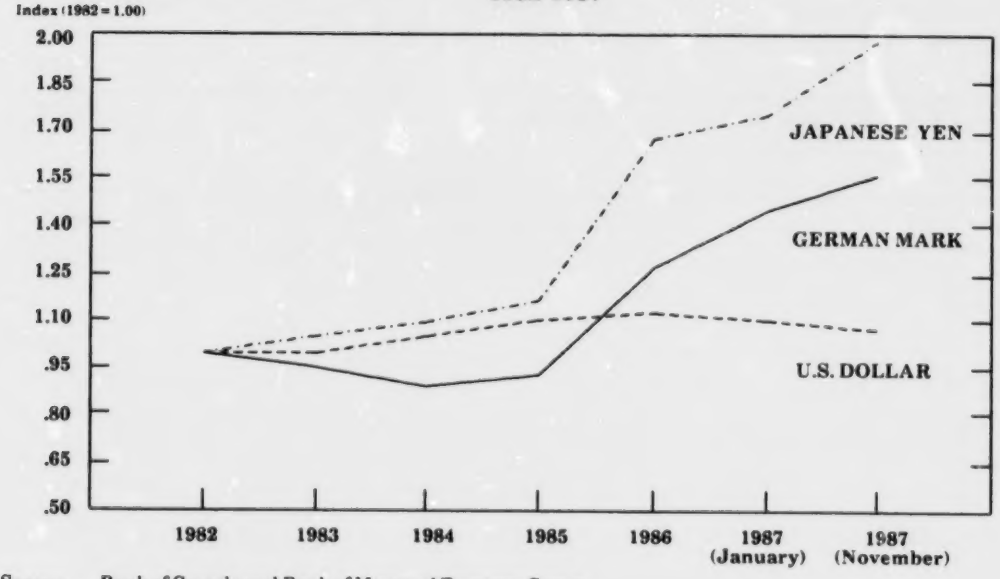
Manufacturing Investment Climate

International Competitiveness

Exchange rate fluctuations can exert a substantial effect on international competitiveness. The Japanese yen and the West German mark have each appreciated almost 80 per cent against the U.S. and Canadian dollars over the past three years. Currencies of other European countries have appreciated against the North American currencies as well, albeit at a somewhat slower pace.

This has resulted in improved competitiveness of Canadian manufacturing and dramatically reduced profitability of the Canadian and U.S. markets for Japanese and European exporters. Japanese exporters are reducing their emphasis on exports to North America, while intensifying their marketing efforts in Europe. At the same time, there is a growing trend for European and Japanese firms to shift towards direct investment in North America. In Ontario, direct investment has been particularly significant in the automotive assembly and parts industries.

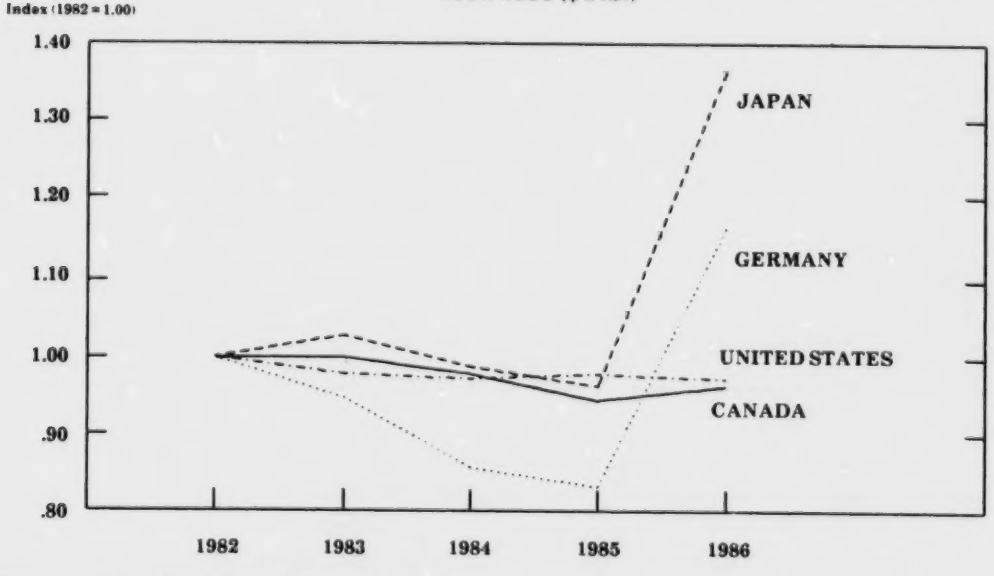
APPRECIATION OF SELECTED CURRENCIES vs. CANADIAN DOLLAR 1982-1987



Source: Bank of Canada and Bank of Montreal Treasury Group.

As the graph below suggests, these movements in exchange rates have resulted in sharp increases in Japanese and German unit labour costs in manufacturing relative to Canada and the United States.

MANUFACTURING UNIT LABOUR COSTS, SELECTED COUNTRIES 1982-1986 ($U.S.)



Source: United States Bureau of Labor Statistics.

Costs of production in Canadian manufacturing now compare favourably with both the United States and Japan in terms of total hourly compensation. This measure includes both money wages and fringe benefits. Recent data indicate that Canadian hourly compensation is distinctly lower in the transportation equipment, machinery, fabricated

metals and chemical industries, at prevailing exchange rates, than in both of the other countries. Indeed, for manufacturing industries as a whole, Canadian hourly labour compensation is roughly equivalent to that in Japan, and significantly lower than that in the U.S.

Hourly Compensation for Selected Industries, Canada, U.S. and Japan **Table 5**
(1986 Cdn. dollars, adjusted for Nov. 1987 exchange rates*)

Industry	Canada	U.S.	Japan
Transportation Equipment	18.18	24.35	19.67
Electrical Products	14.30	17.50	13.90
Textiles	11.56	11.63	11.19
Fabricated Metals	14.58	17.71	15.53
Machinery	15.89	18.98	17.88
Chemicals	16.18	21.86	24.66
Paper	19.96	20.26	16.48
Total Manufacturing	**15.35**	**17.43**	**15.65**

* Relevant exchange rates are:
$1 CDN = $0.758 U.S.
$1 CDN = 102 yen
Source: United States Bureau of Labor Statistics.

Ontario's improved competitiveness has led to increases in employment. As shown in Table 6, since the recession, growth in manufacturing employment in Ontario has been significant relative to that in other countries.

Change in Manufacturing Employment, Ontario and Selected Countries, 1986/1982 **Table 6**
(per cent)

ONTARIO	**7.5**
Japan	5.9
United States	2.1
Sweden	-1.9
W. Germany	-2.4
Norway	-4.6
United Kingdom	-9.8
Italy	-9.9
France	-10.2

Source: United States Bureau of Labor Statistics and Statistics Canada.

Ontario manufacturing shipments to the U.S. have increased sharply during the 1980s, while shipments to the rest of Canada have not grown in proportion. This orientation has been particularly noticeable for transportation equipment, electrical products, furniture and primary metal industries.

In large part, Ontario's increase in exports to the U.S. reflects exchange rate advantages and the upsurge in U.S. demand for autos built in Canada. As a result of the steady decline in the Canadian dollar to approximately U.S. $0.75, wage rates in Ontario are generally lower than those in immediately adjacent states in the U.S. (e.g. Michigan) and competitive with lower wage states such as Georgia. Ontario companies enjoy other competitive advantages, including lower health costs and lower energy costs.

Monthly Electricity Costs for Industry, 1987 **Table 7**
(Canadian dollars)

California (Los Angeles)	32,652
New York (New York City)	44,500
Illinois (Chicago)	39,515
Massachusetts (Boston)	29,057
Ontario (City of Toronto)	20,850

Note: Relevant exchange rate is $1 CDN = $0.758 U.S.
Based on industrial user with 400,000 Kw.h. demand and 1,000 Kw peak load.
Source: Ontario Hydro.

Hourly Earnings for Selected Industries **Table 8**
(1986 Cdn. dollars adjusted for 1987 exchange rates)

		United States		
Industry	Ontario	Michigan	Georgia	Total U.S.
Transportation Equipment	14.30	19.82	17.27	16.90
Electrical Products	11.09	14.18	14.27	12.73
Textiles	10.45	-	8.94	9.14
Fabricated Metals	11.31	16.66	11.75	13.05
Machinery	12.31	17.08	12.90	13.97
Chemicals	12.61	17.04	13.72	15.80
Total Manufacturing	**12.11**	**16.89**	**11.00**	**12.84**

Notes: Relevant exchange rate is $1 CDN = $0.758 U.S.
This table differs from Table 5 in that earnings include overtime but not fringe benefits.
Source: United States Bureau of Labor Statistics and Statistics Canada.

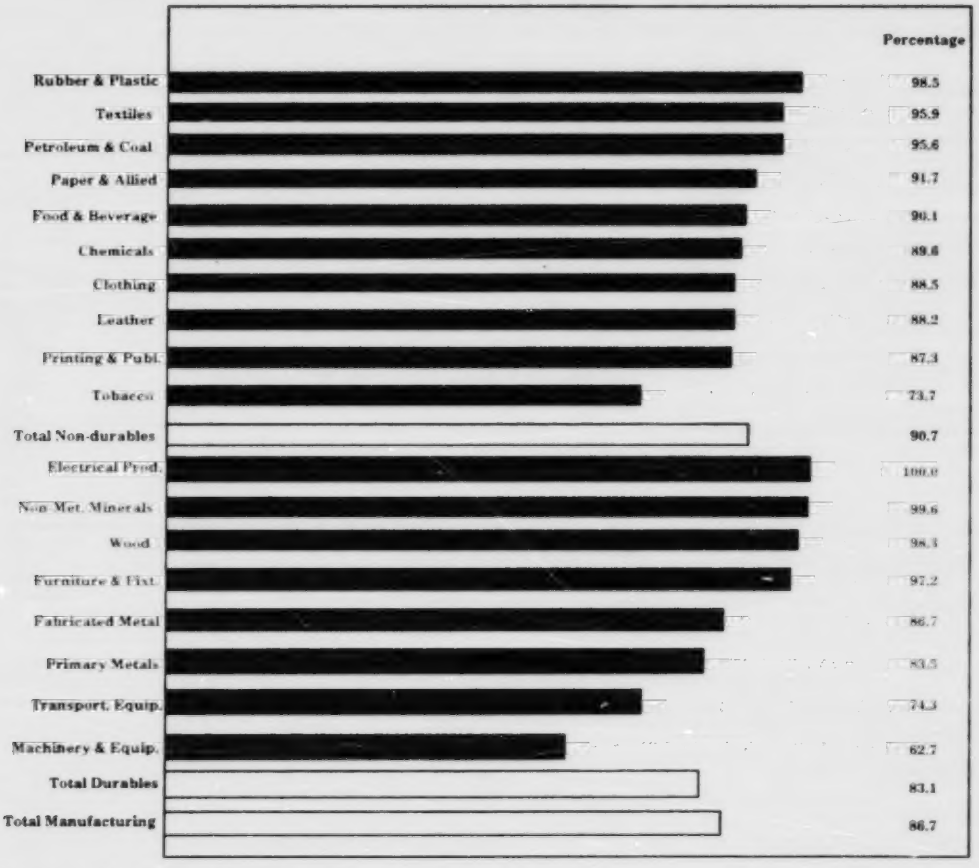
Manufacturing Capacity Utilization

Total manufacturing capacity utilization rose by one percentage point in the first quarter of 1987 to a rate of 86.8 per cent and continued at 86.7 per cent through the second quarter of this year. Non-durable goods industries displayed a higher overall utilization rate (90.7 per cent) than those producing durable goods (83.1 per cent).

Several industries are approaching capacity constraints. In particular, the electrical products, non-metallic minerals, rubber and plastic, wood, furniture, textiles and petroleum industries are all running at more than 95

per cent of capacity. In contrast, the machinery and transportation equipment industries are operating at relatively low (less than 75 per cent) levels of capacity.

CAPACITY UTILIZATION RATES IN CANADIAN MANUFACTURING, SECOND QUARTER 1987



Source: Bank of Canada

Manufacturing Investment Outlook

In recent years, manufacturing investment increases have been largely attributable to the auto and steel industries. In 1987, investment growth has been less dramatic, but more broadly based among industries. This reflects continued growth in consumer demand, high capacity utilization rates, profit growth and continued competitive pressures to improve productivity through purchases of new machinery and equipment.

For 1987, manufacturing sector investment should account for about one-third of Ontario's total business investment. Within manufacturing, the largest share of investment ($2.4 billion) took place in the transportation equipment industry followed by primary metals, food and beverages, chemicals and electrical products.

Industries with substantial increases over last year's investment levels include printing and publishing, wood, electrical products, paper and allied, and food and beverages. Declines occurred in the metal fabricating, textile and related, and primary metal industries.

Investment by Ontario Manufacturing Industries, 1986 and 1987 **Table 9**

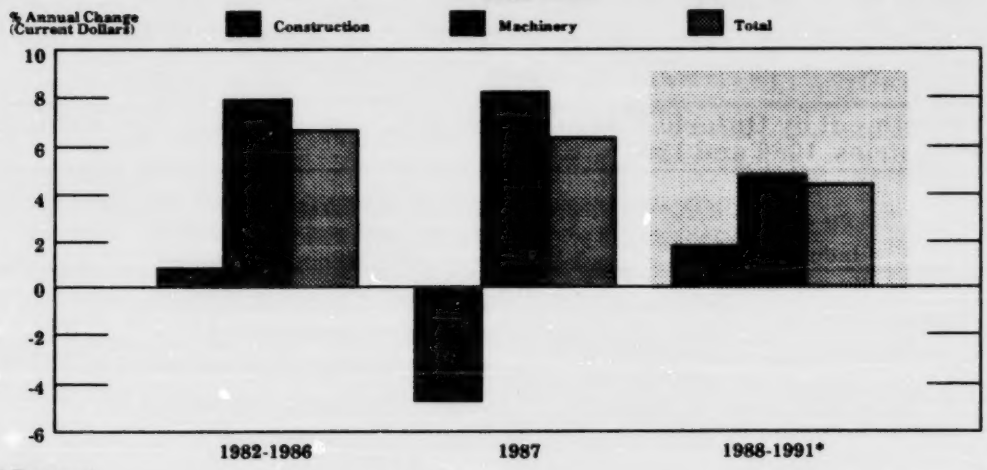
Industries	Actual 1986 $ Million	Intentions 1987 $ Million	1987 Share of Total %	1987/1986 Annual Change %
Resource-based Industries	**1,378.0**	**1,461.7**	**17.7**	**7.9**
Wood	57.5	81.7	1.0	42.1
Paper and Allied	331.6	415.5	5.0	25.3
Primary Metal	988.9	964.5	11.7	(2.5)
Transportation Equipment	**2,379.1**	**2,447.0**	**29.7**	**2.9**
Industrial Products	**2,145.7**	**2,178.6**	**26.4**	**8.5**
Metal Fabricating	572.3	348.1	4.2	(39.2)
Machinery	209.8	238.7	2.9	13.8
Rubber and Plastics	230.7	253.0	3.1	9.7
Electrical Products	353.3	488.0	5.9	38.1
Non-Metallic Minerals	182.1	200.3	2.4	10.0
Chemicals & Petroleum Refining	597.5	650.5	7.9	8.9
Consumer Products	**883.0**	**1,106.8**	**13.4**	**29.4**
Food, Beverages and Tobacco	516.1	644.9	7.8	25.0
Textiles and Related	201.1	197.6	2.4	(1.7)
Furniture and Fixtures	38.1	44.5	0.5	16.8
Printing and Publishing	127.7	219.8	2.7	72.1
Manufacturing Total*	**7,761.5**	**8,245.5**	**100.0**	**6.2**

* Includes miscellaneous manufacturing and capital items charged to operating expenses.
Source: Statistics Canada.

Following substantial average annual growth of 6.6 per cent over the period 1982 to 1986, and a further 6.2 per cent increase in 1987, it is anticipated that manufacturing investment will increase by some 4.3 per cent per year over the forecast period 1988 to 1991. This slowdown reflects the expected slower overall economic growth in Canada and the United States and the completion of major projects in both the auto and steel industries.

New capital investment by Ontario manufacturers will approach $10 billion by 1991. Competitive pressures to improve quality and reduce costs, as well as relatively stable interest rates, will help to encourage outlays for new equipment.

GROWTH IN ONTARIO MANUFACTURING INVESTMENT
1982-1991



* Forecast
Source: Ontario Ministry of Treasury and Economics

Sector Outlook

Overview

For the past five years, the economy has been expanding at a rapid rate, with growth concentrated in relatively few industries. Manufacturing growth averaged 4.4 per cent per year, with much of the impetus coming from extremely high growth in transportation equipment. Primary sector growth averaged 5.1 per cent, buoyed by rapid increases in gold mining.

The outlook for the 1988-1991 period is for continuing but more moderate expansion in both the primary and manufacturing sectors (see Table 10). Growth is expected to be broadly based across most industries, reflecting recent high levels of investment spending and costs that have become more internationally competitive due to recent exchange rate changes.

Primary and Manufacturing Sector Outlook for Ontario **Table 10**
($1981)

	1986		Real Output Annual % Change	
	Employment	Real Output $Million	1987	1988-91
Primary	159,437	6,050	6.0	1.9
Manufacturing	950,834	38,369	2.2	2.4

Source: Conference Board of Canada, Statistics Canada and Ontario Ministry of Treasury and Economics. Forecasts in this section are based on the "base case" medium-term outlook.

Primary Sector Outlook

Ontario agriculture, mining and forestry are experiencing large increases in real output this year. This strong performance is expected to be followed by moderate increases in the next four years.

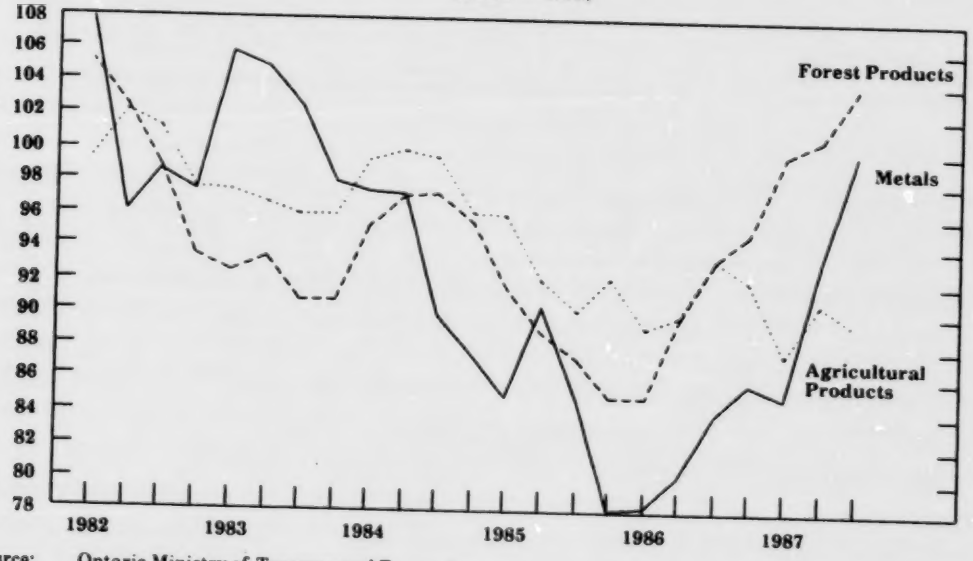
Primary Sector Outlook for Ontario **Table 11**
($1981)

	1986		Real Output Annual % Change	
	Employment	Real Output $Million	1987	1988-91
Primary	**159,437**	**6,050**	**6.0**	**1.9**
Agriculture	128,000	3,114	6.4	1.9
Mining	30,246	2,400	5.8	2.0
Forestry and Fishing	11,191	536	4.8	1.9

Source: Conference Board of Canada, Statistics Canada and Ontario Ministry of Treasury and Economics.

Real prices of Ontario's major resource commodities all declined during the early 1980s. The metals price index (nickel, gold, copper, and zinc) fell most sharply; but in 1986 metal prices began to strengthen dramatically. Similarly, the forest products price index (kraft pulp, newsprint, and lumber) began to recover strongly in 1986 and has now risen above its 1982 level. Agricultural prices have shown less resiliency. Grain prices, especially for corn, are worsening due to the U.S.-E.E.C. agricultural trade war and hog prices are experiencing a cyclical decline.

PRICES OF ONTARIO RESOURCE COMMODITIES
(1982 = 100)



Source: Ontario Ministry of Treasury and Economics.

Agriculture

Total production in Ontario agriculture is expected to grow at about six per cent this year reflecting both an excellent growing season and large buildups of cattle and hog inventories (not included in livestock receipts). Highlights include higher pork, poultry and beef production. Favourable growing conditions this year have increased 1987 output of most grains and oilseeds.

Over the period to 1991, total production will grow at a 1.9 per cent annual rate. Livestock marketings are expected to increase, particularly in 1988 and 1989. Contraction in corn production, due to falling prices, will offset expected increases in soybean production for which prices are expected to remain more stable. This will primarily affect Southwestern Ontario where most cash cropping takes place. Specialty crops are expected to show significant growth due to a shift in acreage from more traditional crops with poor prospects. Nursery crops will continue to benefit from the recent growth in Ontario housing. Little growth in overall fruit and vegetable production is expected due to stiff import competition. Prospects for tobacco production are poor beyond 1989 when the current three-year agreement on crop size ends.

Agricultural Outlook for Ontario — **Table 12**

	Annual % Change	
	1987	1988-91
Total Livestock (Real Receipts)	1.1	1.8
Total Crops (Real Receipts)	0.8	-0.3
Total Intermediate Inputs (Real Operating Costs)*	1.0	-1.1
Real Output**	6.4	1.9

* Includes expenses for machinery, fertilizer and lime, other crop and livestock inputs, repairs to buildings, gross farm rent and miscellaneous expenses.

** Change in real output reflects changes in real receipts less real operating costs, adjusted for changes in inventories, government deficiency payments and income in kind.

Source: Ontario Ministry of Treasury and Economics.

Mining

After several difficult years, conditions in the mining industry have shown dramatic improvement. Metal prices have strengthened substantially as worldwide supply and demand have come into better balance. Overall industry employment, after declining for many years, now appears to be stabilizing. Capital investment in 1987 is expected to exceed $731 million, a 16.6 per cent increase over last year. This includes $149 million in general exploration expenditures, a 35.6 per cent increase over 1986. Most of this investment is related to precious metals, although two significant base metal deposits are also under exploration and development.

Some two-thirds of Ontario's mineral production is accounted for by five metals: nickel, gold, copper, uranium and zinc. Demand for nickel, copper and zinc has firmed up considerably, and with Ontario's producers being among low to average cost producers, they should be able to maintain or expand production. Ontario gold production, after expanding nearly 50 per cent in 1986, is expected to show further but more modest increases over the forecast period. Most of Ontario's uranium production is under long-term contracts with Ontario Hydro and foreign utilities that ensure more or less stable output levels for the next several years.

Forestry

Logging activity has been strong in recent years. Wood harvests are expected to show a four per cent increase this year, reflecting higher demand by pulp mills which consume some 70 per cent of the wood harvested in Ontario. There will also be steady demand by other wood-using industries such as sawmills. However, harvests are expected to slacken somewhat in 1988, mainly as a result of a reduction in sawmilling activity. Forest regeneration activities are expected to continue to expand.

Manufacturing Sector Outlook

As the current economic expansion has matured, growth has become more broadly based across the manufacturing sector. This more balanced pattern of growth is expected to continue, but at a slower pace. The details are shown in Table 13.

Manufacturing Outlook for Ontario **Table 13**
($1981)

	1986		Real Output Annual % Change	
	Employment	Real Output $Million	1987	1988-91
Manufacturing	**950,834**	**38,369**	**2.2**	**2.4**
Resource-based Industries	131,111	6,006	5.2	1.9
Transportation Equipment	141,884	7,002	(8.0)	3.3
Industrial Products	380,372	14,821	4.7	2.3
Consumer Products	297,467	10,541	4.1	2.2

Source: Conference Board of Canada, Statistics Canada and Ontario Ministry of Treasury and Economics.

Resource-based Manufacturing

In 1987, strong increases in real output are being achieved in the resource-based manufacturing industries, with more modest growth expected in following years. The success of Ontario's pulp and paper, wood products and primary metal industries depends to a large extent on world market conditions.

Strong North American demand has led to a record level of **pulp and paper** production in Ontario. This, coupled with increased prices, has resulted in substantially improved profits. The current boom is expected to extend through 1988 before slowing down. Longer-term projections of two to three per cent annual growth in world demand, and the availability of surplus forest resources in some parts of the province, suggest opportunities for expansion. Two companies are currently undertaking upgrading and expansion involving $530 million.

Wood products production is also at a high level, owing to buoyant residential construction and renovation markets. Output is expected to decline by 1989 as residential construction returns to more moderate levels during the forecast period.

Ontario's steel industry has been relatively successful compared to its counterparts in the U.S. and other O.E.C.D. countries. Ontario steel production in 1987 is expected to have grown five per cent over last year. Mills have also made substantial capital investments -- $4 billion since 1980 -- to reduce costs and improve product quality. Overall prospects for the 1988-91 period remain good. The improved climate for energy-related investment will be of particular benefit to producers of steel pipe and tube such as Algoma Steel.

Transportation Equipment

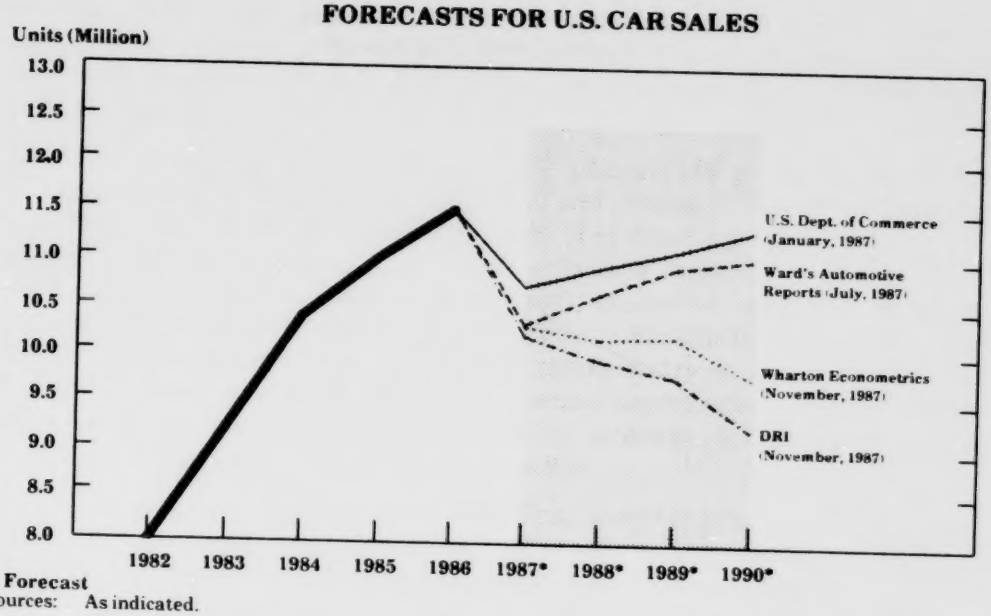
During 1987, the Ontario transportation equipment industry experienced a decline in output. In the first ten months of the year, Canadian vehicle production declined by 15.7 per cent, mainly due to lengthy shutdowns for plant conversions and slower than anticipated production start-ups at the new GM-10 car plant and the GMT-400 truck plant in Oshawa. For the rest of 1987, output will be further weakened by the elimination of one of two shifts at GM's #1 car plant in Oshawa. This plant is scheduled for changeover to GM-10 production in 1988. It also appears that an expected boost to production from Chrysler's new Bramalea plant (acquired from AMC) will be further delayed owing to start-up difficulties.

The outlook for the transportation equipment sector is dominated by the outlook for the auto industry which accounts for 85 per cent of transportation equipment shipments and employment. In turn, the outlook for the Ontario auto industry is primarily dependent on U.S. market conditions and the relative competitiveness of Ontario's industry vis-a-vis the U.S. and other countries, particularly Japan.

In 1986, Ontario accounted for 13 per cent of North American motor vehicle assembly capacity and exported 83 per cent of its production of motor vehicles (cars, trucks, and vans) to the U.S.

After four years of growth, culminating with a record sales level in 1986, U.S. car sales fell for the first ten months of this year. Forecasts call for declines for the year as a whole within a range of 10.1 per cent to 10.5 per cent. Following the stock market crash some recent U.S. forecasts have become more pessimistic about the outlook over the next few years as well. For 1988, further declines for the U. S. market are anticipated within the range of one to three per cent. These are lower than earlier forecasts, especially those by the U.S. Department of Commerce and Ward's Automotive Reports. The most pessimistic of these forecasts is unlikely, especially if 1991 is included in the forecast horizon.

FORECASTS FOR U.S. CAR SALES



* Forecast
Sources: As indicated.

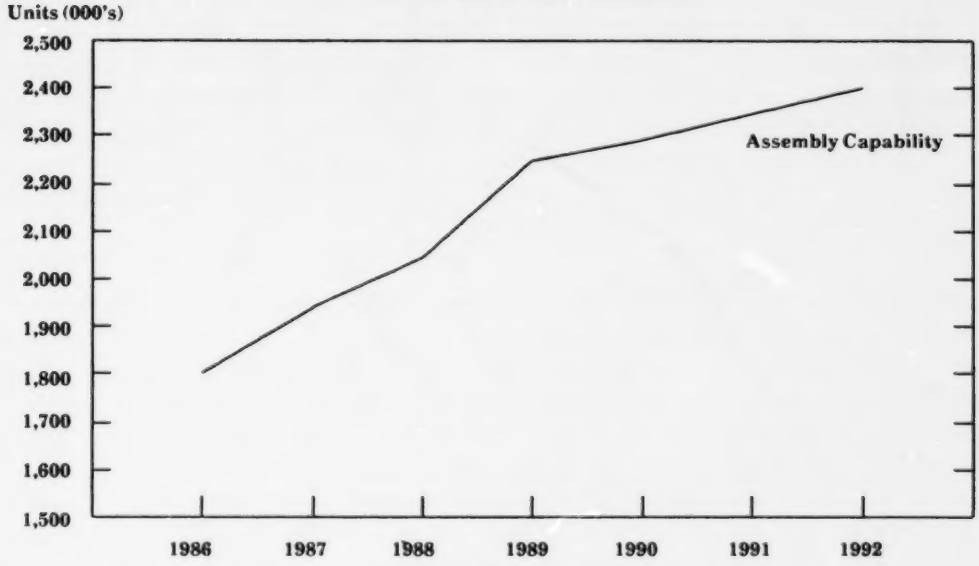
Despite Ontario's dependence on the U.S. automotive market and the softening outlook for that market in the near term, it is anticipated that Ontario's production will increase in 1988 as the industry recovers market share that was lost in 1987 due to plant conversions and model changeovers. It is also anticipated that Ontario production will generally increase through the 1989-91 period. This is expected to result from the bringing on stream of additional capacity now under construction, a gradual recovery in the U.S. auto market and increased market share for North American built autos (including Japanese North American production). Accordingly, Ontario's share of North American sales and North American production is expected to increase.

The reason for this expectation is that Ontario has a substantial competitive advantage stemming from a lower Canadian dollar, and lower labour, energy, and materials costs. Ontario has also benefitted from specialization in more successful product segments such as larger cars, mini-vans, and light trucks and vans.

The outlook for the medium term is further enhanced by technologically advanced additions to Ontario's assembly capability. Ontario's assembly capability by 1992 is expected to be roughly 600,000 units or 33 per cent ahead of that estimated for 1986. It is anticipated that this additional capacity, expected from both new and expanded plants, will be phased in gradually over the period. Most of this capability is expected to displace imports from Japan and fill market niches where the sales outlook is favourable.

The impact of the Canada-U.S. trade agreement on investment in the auto parts sector remains uncertain, particularly since the North American content rules for duty free status may be the subject of renewed negotiation. In any case, the proposed agreement does not contain safeguards with respect to the Canadian share of future investment from offshore in assembly or parts.

ADDITIONS TO ONTARIO'S AUTO ASSEMBLY CAPABILITY



Note: Assembly capability measures output potential. Annual changes to Ontario's assembly capability are estimated at less than total changes in planned plant capacity to reflect a gradual phase-in of new plants.
Source: Ontario Ministry of Treasury and Economics.

Industrial Products

Industrial product manufacturers include the machinery, fabricated metals, non-metallic minerals, electrical and electronic products, rubber and plastics, and chemicals and refining industries.

The **machinery** industry has rebounded strongly since the recession. The high level of Canadian industry investment spending for machinery and equipment expected this year has had a positive impact on the machinery industry in Ontario. However, this impact is, as always, somewhat diminished by the chronically high import content of business spending on machinery and equipment.

Shipments were up 14 per cent in the first half of 1987. The demand for manufacturing and services-related machinery and equipment should remain firm as should demand for forestry and pulp and paper machinery.

Continued steady growth is expected in the industry-oriented segment of the **electrical products** industry due to business investment in information technology and process equipment. The strong housing market has been a stimulus to appliance demand, but import penetration continues at very high levels.

A somewhat mixed performance is expected from **rubber and plastics**. The rubber component is experiencing weakness due to slack automobile demand and rationalization in the tire industry. Employment and output for rubber are declining as a result of the Goodyear tire plant closing earlier this year, and the Firestone closing announced for January 1988. The manufacturers of plastic products can be expected to pick up some

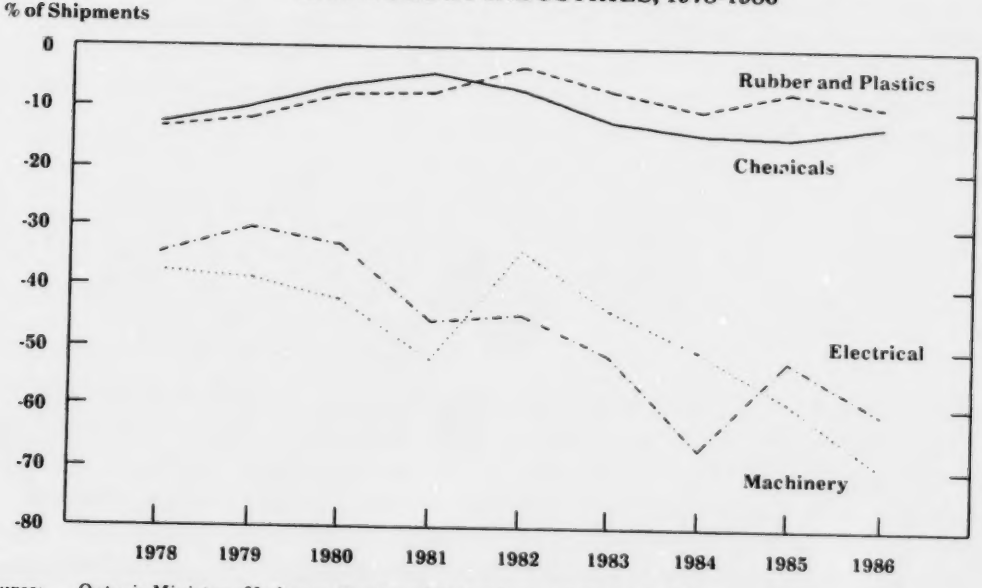
momentum over the short to medium term, continuing the general improvement in performance that began in 1983. Plastic products appear to have been capturing market share from more traditional materials such as metals and glass.

Over the short and medium terms, the **chemicals** group is expected generally to follow overall performance of the economy. Lower oil and gas prices have increased the competitiveness of synthetic products relative to natural products (metals, fibres, rubber) so that increasing displacement can be expected in the automotive, aircraft, electrical, textile, packaging, housing and consumer products industries. Research capabilities and efforts in Ontario are at the forefront of the industry in many areas. The plastics and resins, soap, toiletries and miscellaneous chemicals segments are expected to outperform the industry average while agricultural chemicals will exhibit below-average growth.

These industries - **rubber and plastics, machinery, electrical and electronic** products, and **chemicals** - were among those assigned a "high-technology" status by the Economic Council of Canada's 1987 study, Innovation and Jobs in Canada (based on value of high-technology inputs as a proportion of all non-labour inputs).

The chart below shows the export and import performances of the group as a whole over the period 1978 to 1986. During this period, although exports have been increasing, imports have been increasing at a greater rate. Ontario's international trade deficit on these goods grew from $4.0 billion in 1978 to $10.4 billion in 1986. Even as a percentage of total shipments, Ontario's international trade deficit in these goods has shown a steady worsening, especially since the recession.

ONTARIO TRADE DEFICIT FOR SELECTED HIGH TECHNOLOGY INDUSTRIES, 1978-1986



Source: Ontario Ministry of Industry, Trade and Technology and Ministry of Treasury and Economics.

In **petroleum refining**, the process of plant rationalization and modification has left Ontario refineries well adapted to meet efficiently the demand in the next decade. Modest increases in transportation fuel production will be partially offset by reduced production of heavy fuel oils and heating oils. Residential and commercial heating oils currently represent 13 per cent of petroleum product consumption (compared to 40 per cent ten years ago). Future capital and repair expenditures are likely to be around $150 million per year, down from recent levels of $250 million per year.

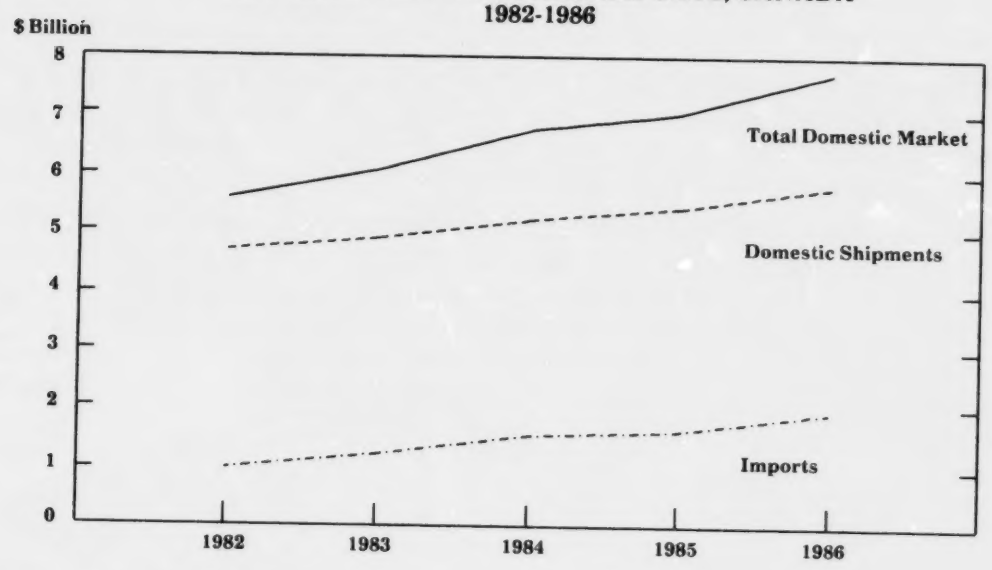
Shipments from the **fabricated metal** and **non-metallic products** industries increased by 9.2 per cent and 18.3 per cent respectively in the first half of 1987 over the same period last year. Strong capital investment continues to stimulate demand for metal doors and windows, heating equipment, cement, brick, glass, etc.

Consumer Products

This group includes the food, beverage and tobacco, leather, textiles and clothing, furniture, and printing and publishing industries. Steady growth is expected in both output and employment from this group of industries over the next four years.

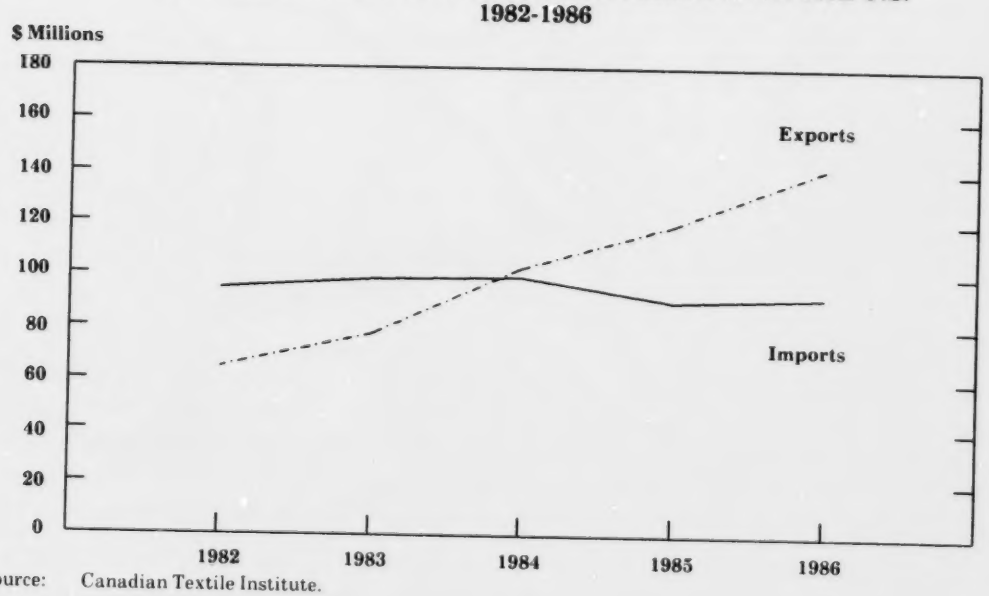
Increasing import penetration from lower-wage Asian producers in the **clothing and footwear** industries, and from high-volume U.S. operators in the **textiles** industry, continues to dampen performance in this sector. There are, however, some noteworthy exceptions to sluggish domestic production among the more specialized clothing designers and manufacturers. As the graphs below demonstrate, despite growing imports, domestic apparel shipments remain a significant proportion of the total and are increasing. In the case of apparel trade, imports are primarily from low-cost countries (both in terms of number of units as well as dollar value). Canadian exports, mostly to the United States, are of high-value items. Imports tend to be low-cost, low-value items. This in part explains a reversal in Canada's trade position in these products against the United States, from a deficit to a healthy surplus.

APPAREL SHIPMENTS AND IMPORTS, CANADA
1982-1986



Source: Canadian Textile Institute.

APPAREL INDUSTRY: CANADIAN TRADE WITH THE U.S.
1982-1986



Source: Canadian Textile Institute.

The **food and beverage** industry is the second largest, after transportation equipment, within the manufacturing sector in Ontario. There are 96,000 persons employed in this sector. Ontario's trade deficit in this sector is about $600 million. As a relatively small proportion of output is exported, the industry relies heavily on domestic consumption. Expansion has been restrained by slower population growth; but the snack food sector has been unusually strong and is expected to remain so with a steady stream of new

products. In competing with U.S. food processors, the industry's performance is hampered by higher costs.

Shipments in the **printing and publishing** industry increased by eight per cent in the first six months of 1987 over the same period last year. Capital investment is very strong - a total of $220 million anticipated for 1987 representing an increase of 72 per cent from the previous year.

The **furniture and fixtures** industry has been benefitting from high levels of new housing and office construction. Output has risen rapidly since the recession and the industry is now operating at full capacity with significant order backlogs and labour shortages. The medium-term outlook is for continued growth. For the next two years, the industry will continue to benefit from the large number of housing starts and high level of office construction in 1986 and 1987.

Service Sector Outlook

Since 1971, the service sector has averaged a real growth rate of 3.5 per cent per year, compared to 3.0 per cent for the economy as a whole. Employment growth in services has been equally impressive. The service sector also shows less cyclical variability in output. Even during the 1982 recession, when other sectors experienced varying degrees of setback, services managed 0.2 per cent growth in output.

Services are expected to continue to grow more strongly than the economy over the medium term. Real output in this sector will grow by 2.7 per cent per annum to 1991.

One sector of particular importance to Ontario's economy is financial services. This sector has recently witnessed dramatic changes in its international structure and its regulatory climate. Moreover, in the past month, the world stock market crisis has also had important effects.

Tourism Sector Outlook

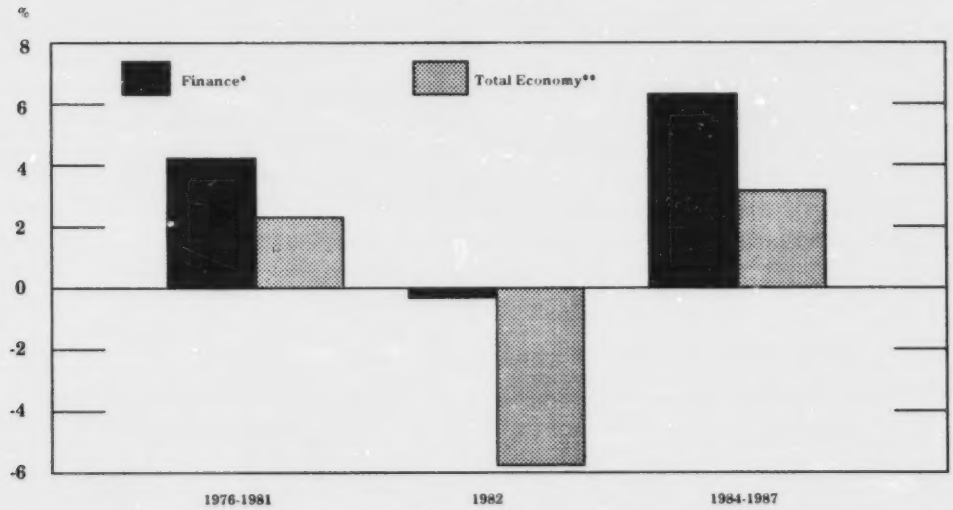
Growing real incomes in industrial countries, more personal leisure time and expanding business travel are causing the tourism market to expand rapidly. Ontario is well positioned with its good image, diverse society, strong economy and excellent location with respect to major tourism markets to compete for a larger share of this global megamarket.

Tourism is a major sector of the Ontario economy, accounting for 4.2 per cent of Ontario jobs. Following an exceptionally strong performance in 1986, tourism spending in Ontario is expected to have been over $9.3 billion this year. This is the second year of very strong growth. The currency realignments of recent years will improve Canada's attractiveness to the Japanese and Europeans. Currency changes will also encourage more Canadians to remain in North America.

Financial Services Outlook

The financial services industry is one of the most rapidly growing sectors of the Ontario economy and a major employer in the province. The industry was less adversely affected by the 1982 recession than other sectors and has since grown strongly. Although the recent declines in stock prices may cause a pause in growth, the medium-term outlook for this industry remains favourable.

AVERAGE ANNUAL EMPLOYMENT GROWTH IN FINANCIAL SERVICES AND TOTAL ECONOMY, ONTARIO 1976-1987



Note: 1983 growth rate is not available due to a break in the data series.
* Excludes insurance.
** Excludes agriculture, fishing, trapping, religious organizations, private household services and defence; pre-1983 also excludes public administration, education, health and welfare.

Source: Statistics Canada.

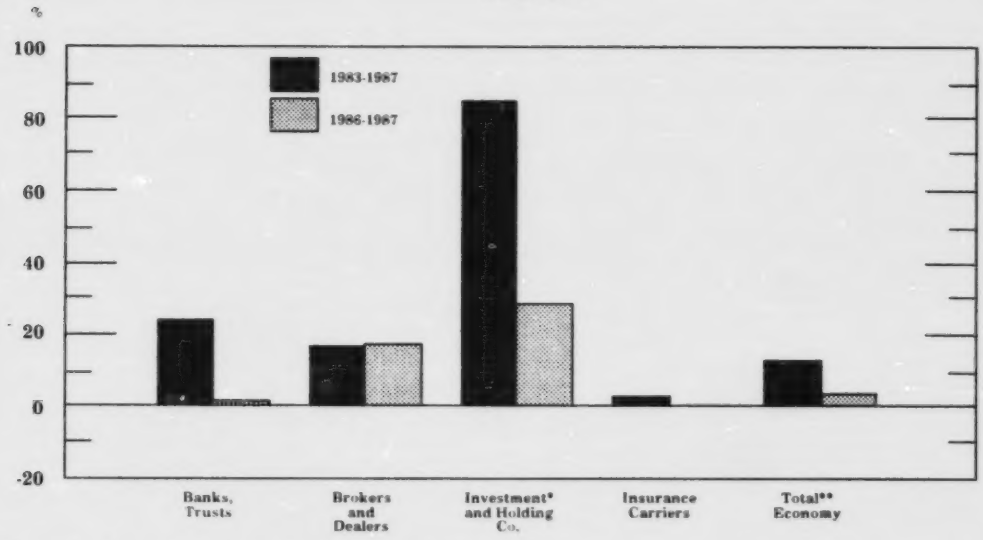
Banks and trust companies are by far the most important employers in Ontario's financial sector, providing 108,000 jobs and accounting for 55 per cent of this sector's employment. Insurance companies account for almost 25 per cent of financial sector employment, followed by investment and holding companies (9.9 per cent) and security brokers and dealers (6.7 per cent). Other credit agencies, including finance companies, account for less than four per cent.

Growth in employment since 1983 has been more evident in some industry segments than others, although in no segment has employment actually declined over the period as a whole. Investment companies (including mutual funds) have experienced the greatest surge. In the near term, investment companies and security brokers and dealers are the industry segments most likely to be affected by the recent declines in the stock market.

Employment in banks and trust companies has grown faster than in the economy as a whole since 1983. Insurance companies have experienced very little growth in employment over this period. Employment in banks, trust

and insurance companies is less likely to be directly affected by recent stock market conditions.

EMPLOYMENT GROWTH IN THE FINANCIAL SECTOR, ONTARIO 1983-1987



Note: Calculations based on employment in July, 1983, 1986, 1987.
* Includes mutual and closed-end funds.
** Excludes agriculture, fishing, trapping, religious organizations, private household services and defence.
Source: Statistics Canada.

The relatively rapid growth experienced by the industry in recent years reflects much longer-run trends. As consumer income has increased, and as the industry has developed new and more attractive vehicles to match saving and investment, the demand for financial services in Canada has expanded faster than the demand for goods and services generally.

Foreign ownership is expected to increase in financial services as regulatory constraints are removed. While before June 30, foreign-controlled securities firms accounted for less than ten per cent of the Ontario industry's capital, changes in the regulations have opened up opportunities for foreign firms. The changes in Ontario's securities regulations will lead to new entry and expansion of foreign firms in Toronto.

If the Canada-U.S. free trade agreement is approved, U.S.-owned banks will no longer be constrained by the limitation of the foreign-controlled share of domestic bank assets to 16 per cent and can be expected to increase their market share.

Increased taxes on the financial sector are expected as a result of tax reform. It is anticipated that the industry will be able to adjust to the new tax environment without major difficulty.

Ontario Fiscal Review

Revenue Structure*

This section provides a brief overview of Ontario's revenue structure and describes some of its key characteristics.

Composition of Provincial Revenues

The Province has a broad range of revenue sources including taxation, transfer payments from the federal government, other budgetary revenue and non-budgetary sources.

The three major taxation sources – personal income tax, corporation taxes, and retail sales tax – contribute 58 per cent of estimated total 1987-88 revenue. Taxation of gasoline and diesel fuels contributes a further 4.0 per cent. In total, approximately 66 per cent of 1987-88 revenue will be raised through taxation.

Transfer payments from the federal government account for 15 per cent of 1987-88 revenue. Within federal transfer payments, Established Programs Financing and Canada Assistance Plan payments account for 56 per cent and 26 per cent respectively.

Other budgetary revenue sources include OHIP premiums, fees and licences, LCBO profits, interest on investments and lottery profit revenue. These sources contribute 14 per cent of this year's revenue.

Non-budgetary revenues, including net deposits in trust accounts and net repayments of loans and investments, account for the remaining 5.0 per cent of total revenue.

Canadian Tax Reform

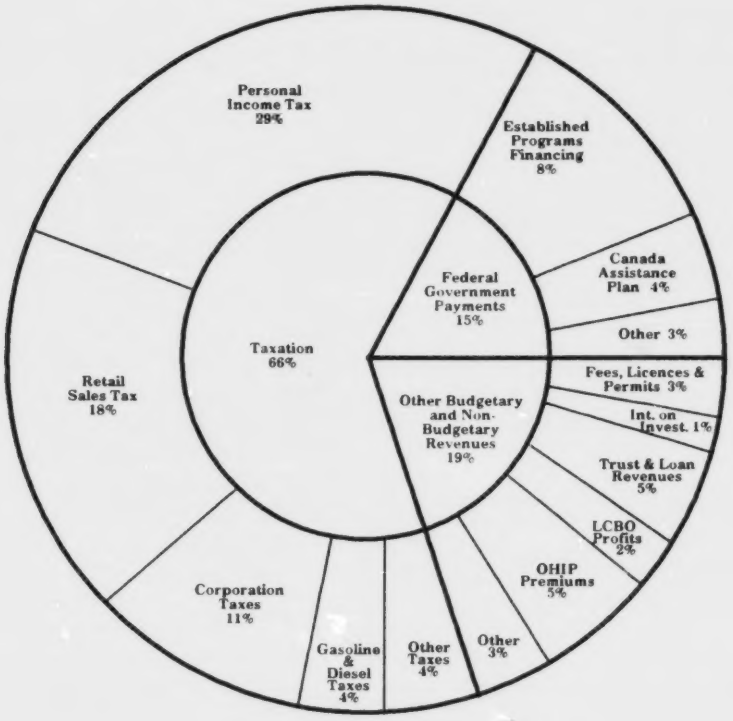
In June of this year, the federal government in Canada released its proposed package for tax reform. Reform has the potential to substantially change the structure of the Canadian tax system. The impact of the proposed federal reforms on individuals, business and the economy could be significant. Ontario has been assessing the social, fiscal and economic implications of these reforms which involve broadening tax bases and lowering rates.

Although the target date for the first phase of federal reform is January 1, 1988, the details of the legislation are yet to be finalized. Amendments will likely be made to the legislative package before implementation. As well, the content and implementation date of the second phase of federal reform, which is expected to center on a multi-stage sales tax, remains unclear. Once the details of the final federal legislation become known, supplemental information will be provided.

The following description reflects the existing tax system.

* All Ontario revenue figures for 1987-88 are based on the September 30, 1987, Ontario Finances.

COMPOSITION OF ONTARIO REVENUES
1987-88*



*** Forecast**
Source: Ontario Ministry of Treasury and Economics.

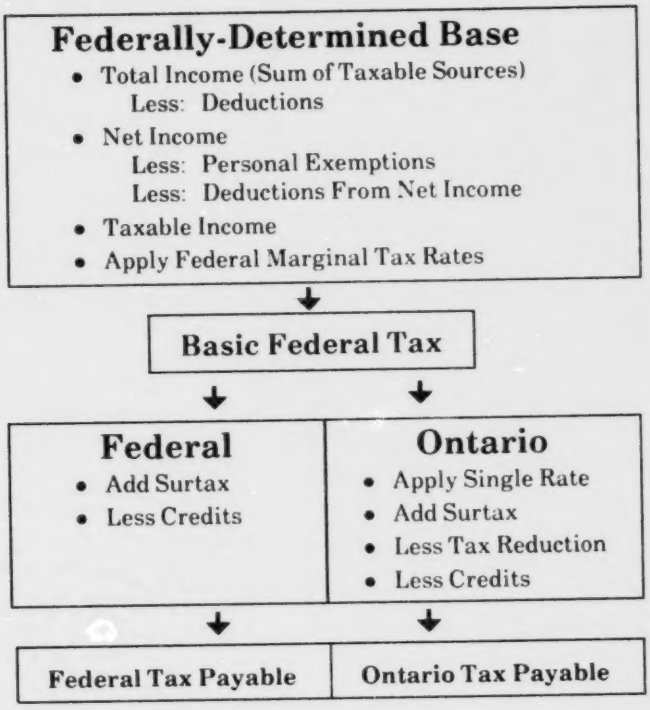
The Major Taxation Sources

Personal Income Tax

Under the terms of the Tax Collection Agreement between the Government of Canada and the Government of Ontario, the federal government collects and administers the Ontario personal income tax on behalf of the Province. The federal government determines the tax base i.e. establishes the definition of taxable income. Basic Federal Tax is calculated by applying a marginal rate structure to this base. Total federal tax is then determined by applying federal surtaxes and credits. Ontario personal income tax is defined as a proportion of Basic Federal Tax. For 1987, the Ontario rate is 50.0 per cent. In addition, a surtax of 3 per cent is applied to Ontario tax in excess of $5,000. Ontario income tax accounts for roughly one-third of an individual's total income tax.

The diagram below illustrates the operation of the personal income tax system.

THE PERSONAL INCOME TAX SYSTEM



With a few exceptions, such as social assistance payments and lottery winnings, all sources of income are subject to tax. Deductions and exemptions are provided for certain personal and income earning expenses. Provisions in the personal income tax system also support investment and saving for retirement.

The federal marginal tax rates for 1987, including federal surtaxes, range from 6.18 per cent in the lowest bracket to 35.02 per cent on income in the highest tax bracket. Ontario marginal rates, before consideration of surtaxes, are one-half of the basic federal rates. Actual Ontario rates after incorporating the Ontario surtax range up to a maximum of 17.51 per cent for 1987. Combining the two rate structures yields a 1987 maximum total marginal rate of 52.53 per cent.

Table 1 illustrates the marginal rate structures.

Federal and Ontario Marginal Personal Income Tax (PIT) Rates, 1987 — **Table 1**

Taxable Income $	Federal PIT Rate* %	Ontario PIT Rate*** %	Combined Federal/Ontario PIT Rates %
1,320 or Less	6.18	3.0	9.18
1,320- 2,639	16.48	8.0	24.48
2,639 - 5,279	17.51	8.5	26.01
5,279 - 7,918	18.54	9.0	27.54
7,918 - 13,197	19.57	9.5	29.07
13,197 - 18,476	20.60	10.0	30.60
18,476 - 23,755	23.69	11.5	35.19
23,755 - 36,952	25.75	12.5	38.25
36,952 - 44,332	30.90	15.0	45.90
44,332 - 63,347	30.90	15.45**	46.35
over 63,347	35.02	17.51**	52.53

* Includes the 3% federal surtax.
** Includes the 3% Ontario surtax on Ontario tax over $5,000.
*** Does not include Ontario Tax Reduction.

Ontario has special programs to relieve tax burdens on low-income Ontarians. The Ontario Tax Reduction removes from the 1987 tax roll 500,000 individuals with taxable income of $2,075 or less. Another 50,000 individuals with taxable income between $2,075 and $2,275 pay reduced Ontario tax. There is no comparable federal tax reduction for low-income taxpayers. In addition, Ontario provides refundable Property and Sales Tax Credits that will return $360 million to Ontario taxpayers in respect of the 1987 tax year. The Property Tax Credit, claimed by the spouse with the higher taxable income, is equal to $230 plus 10.0 per cent of property tax or 2.0 per cent of rent. The Sales Tax Credit is calculated as 1.0 per cent of personal exemptions. These credits are collectively reduced by 2.0 per cent of taxable income. Over 90.0 per cent of these tax credit benefits are received by individuals earning less than $25,000.

Corporate Taxes

The Province of Ontario levies three general taxes on the corporate sector: Corporations Income Tax, Capital Tax and Insurance Premiums Tax. Mining companies are also subject to the Mining Tax. All corporations in Ontario, with the exception of insurance companies, are required to pay Capital Tax based on their paid-up capital. Insurance companies pay Insurance Premiums Tax based on the amount of premiums received in respect of Ontario policies.

The largest amount of corporate revenue is generated through the corporations income tax. Ontario determines the corporations income tax base and rate structure for the Province. Although significant differences have existed from time to time, Ontario's current base essentially parallels the federal corporate income tax base. Tax is imposed on gross corporate

revenues earned in the taxation year less allowable expenses. Various corporate activities receive special treatment through lower rates or accelerated deductions. Capital Taxes and Insurance Premiums Taxes are deductible expenses for federal and Ontario corporate income tax purposes.

The 1987 general corporations income tax rate is 15.5 per cent of taxable income. Income from manufacturing and processing operations, mining, logging, farming and fishing is taxed at the rate of 14.5 per cent.

Eligible small businesses are exempt from income tax in the first three years of their operation and pay tax at a 10.0 per cent rate thereafter.

Ontario, Alberta and Quebec administer their own corporations income tax. All other provinces have entered into tax collection agreements with the federal government.

Retail Sales Tax

The retail sales tax is payable on the sale of most goods and on certain services. The tax is calculated as a specific percentage of the final sale price to the consumer (including any federal levies). Since 1973, the general retail sales tax rate applying to most taxable items has been set at 7.0 per cent. Three other rates apply to specific items and services: 5.0 per cent on transient accommodation; 10.0 per cent on admission fees over $4 and beverage alcohol products sold at licensed establishments; and 12.0 per cent on beverage alcohol products sold at retail outlets.

A number of items are specifically exempt from retail sales tax. The most notable include groceries, energy used for heating and lighting, children's clothing, prescription drugs, specific reading material and production machinery and equipment. Most services are excluded from the retail sales tax base.

Ontario's retail sales tax base and rates are determined by the Province. Registered vendors collect the tax as agents of the Province and remit it to the government.

Motive Fuel Taxes

Ontario levies tax on motive fuels under the authority of two Acts - the Gasoline Tax Act and the Fuel Tax Act. Under both Acts, the tax base is applied to conventional petroleum-based products. Non-conventional fuels such as natural gas, propane, alcohol (used alone or blended with another fuel) and other manufactured gases are exempt.

Fuel taxes are levied on a per litre basis. The Provincial tax is 8.3 cents per litre on gasoline purchased in Ontario. This tax applies to licensed motor vehicles, snowmobiles and pleasure marine craft. Farming, commercial fishing, industrial, commercial, institutional, heating and cooking uses qualify for an exemption or a full rebate of taxes paid, provided that the fuel is consumed off-road.

All aviation fuels purchased in Ontario are subject to a tax of 1.88 cents per litre.

Diesel fuel purchased in Ontario for use in licensed on-road motor vehicles is subject to tax of 9.9 cents per litre. As with the gasoline tax, certain off-road

uses qualify for a full rebate of tax paid or are exempt at the time of purchase. A system of fuel colouration is in place to distinguish diesel fuels sold for exempt purposes, such as farming.

A tax of 3.1 cents per litre is applied to diesel fuel purchased in Ontario to power railroad locomotives.

Per Point Yields

Table 2 illustrates the 1987-88 revenue yield of selected revenue sources on a per point basis. The yields reflect a full year's revenue and in each case the tax points relate to a specific base.

Per Point Yield, 1987-88 **Table 2**

($ Million)

Retail Sales Tax		
7% - General	822	
5% - Transient Accommodation	11	
12% - Alcohol (Retail Outlets)	26	
10% - Alcohol (Licensed Premises) and Admission Fees	15	
Personal Income Tax	194	
Corporate Income Tax		
15.5% - General	84	
14.5% - Manufacturing and Processing, Fishing, Logging and Farming	77	
10% - Small Business	55	
Capital Tax	166	Per 1/10 point
Tobacco Tax	11	1¢ per pack of 20
Motive Fuel Taxes		
Gasoline & Aviation Fuel	140	1¢ per litre
Road and Rail Diesel	35	1¢ per litre
OHIP Premiums (Individual and Family)	57	Per $1/$2
Land Transfer Tax	55	Per 1/10 point

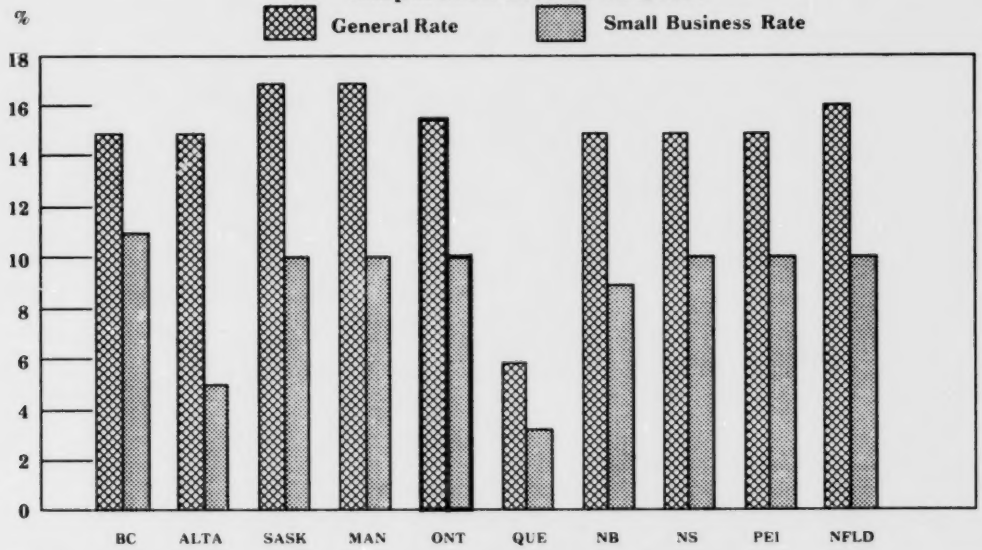
Note: See text for interpretation of these data.
Source: Ontario Ministry of Treasury and Economics.

For example, one percentage point on the general retail sales tax rate yields approximately $822 million. The per point yield of the personal income tax is illustrated as an incremental percentage of Basic Federal Tax, and each percentage point yields $194 million.

Interprovincial Comparison

As illustrated in the following chart, Ontario's general and small business corporate income tax rates are comparable with those in most Canadian provinces but are above rates in Alberta and Quebec.

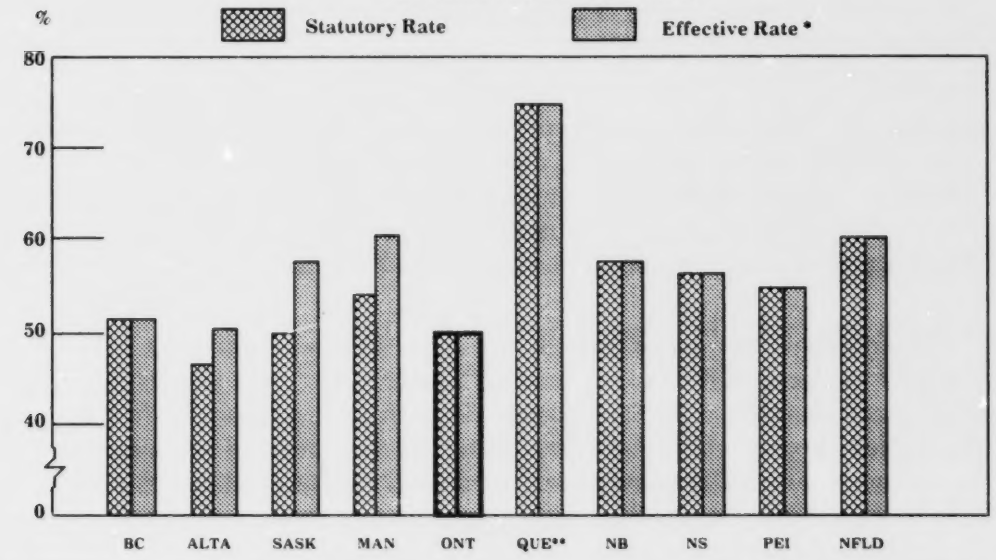
INTERPROVINCIAL TAX COMPARISON:
Corporation Income Tax, 1987



Source: Ontario Ministry of Treasury and Economics and provincial tax statutes.

Provincial personal income tax rates and provincial personal income tax revenues as a percentage of Basic Federal Tax are illustrated below. Ontario's effective rate is 50.0 per cent, including the impacts of the Ontario Tax Reduction and surtax.

INTERPROVINCIAL TAX COMPARISON:
Personal Income Tax, 1987



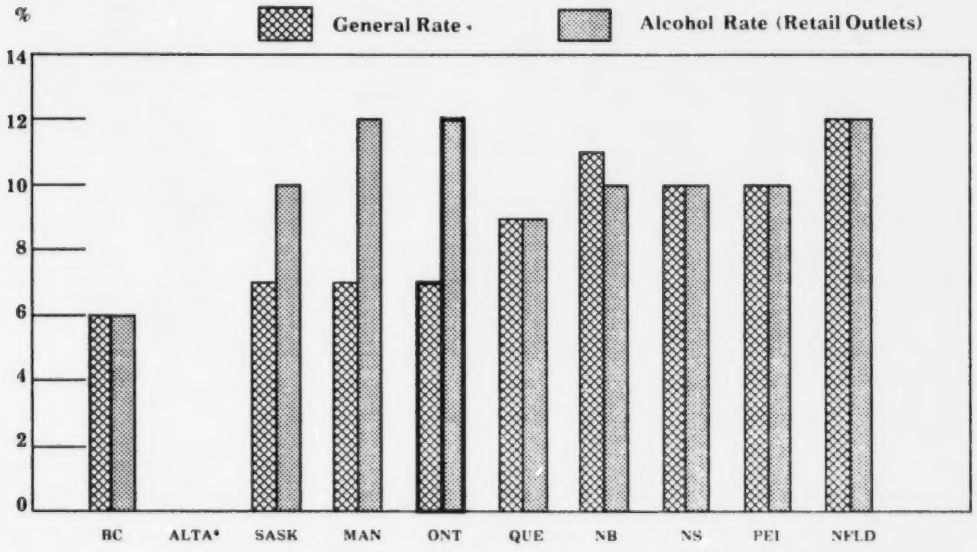
Notes: * Effective rate is total provincial income tax revenue, including any surtaxes and net of any tax reductions, as a percentage of basic federal tax assessed in the province.

** Estimated rate; Quebec does not impose tax as a percentage of basic federal tax.

Source: Ontario Ministry of Treasury and Economics and provincial tax statutes.

The general retail sales tax rates in Canada range from zero per cent in Alberta to 12.0 per cent in Newfoundland. Ontario's rate is approximately in the middle of the range at 7.0 per cent.

INTERPROVINCIAL TAX COMPARISON:
Retail Sales Tax, 1987



Note: * No provincial sales tax is imposed.

Source: Ontario Ministry of Treasury and Economics and provincial tax statutes.

Straight rate comparisons must, however, be used with caution. Differences in the taxable base are particularly important in interprovincial comparisons of retail sales tax. Significant interprovincial differences in retail sales tax exemptions exist in areas such as advertising, insurance premiums, transient accommodation and personal services.

Relative tax rates in these major tax areas also reflect the approach taken in each province to support health care expenditures. Ontario, Alberta and British Columbia raise additional revenue through Health Insurance Premiums ranging from $168 annually for a single individual in Alberta to $357 for an individual in Ontario. Quebec and Manitoba levy payroll taxes.

Ontario and Neighbouring U.S. Jurisdictions

Many of the proposed changes in the Canadian tax reform package follow changes made to the U.S. system. The U.S. Tax Reform Act of 1986 introduced a comprehensive overhaul of the U.S. federal tax system. The Act reduces personal and corporate income tax rates, and broadens the tax base by eliminating or scaling back many tax preferences. Overall, the new tax law significantly reduces personal income tax liability and increases corporate liability.

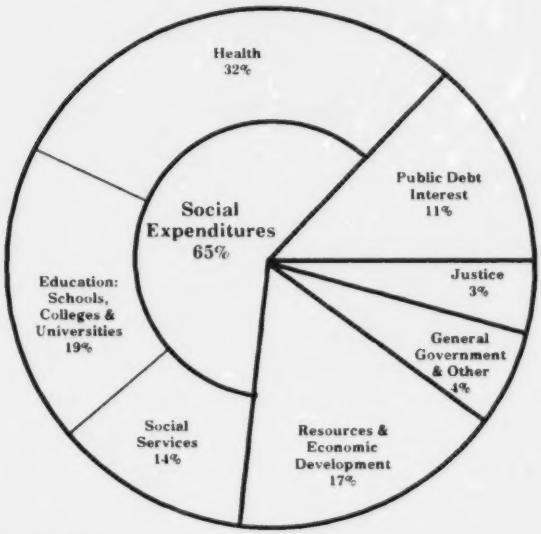
The need to maintain a competitive tax system with other jurisictions, particularly those in the United States, is a major objective of Canadian tax reform. The substantial difference in personal income tax rates between

Canada and the U.S. as well as the risk to Canadian corporation tax revenues from U.S. changes are critically important considerations for Ontario. However, a direct comparison between the tax systems in Ontario and neighbouring U.S. jurisdictions would be premature at this time because both systems are in transitional stages.

Expenditure Structure*

Provincial expenditures support a wide range of programs, services and capital projects. This spending will amount to approximately $35.2 billion in 1987-88. Key components of Ontario's expenditures are shown in the following graph.

DISTRIBUTION OF ONTARIO'S EXPENDITURES
1987-88 *



*** Forecast as at September 30, 1987**
Source: Ministry of Treasury and Economics.

Expenditures on social programs will account for 65 per cent of Provincial spending. These social expenditures include funding to support Ontario's health care and education systems, as well as social assistance programs and services.

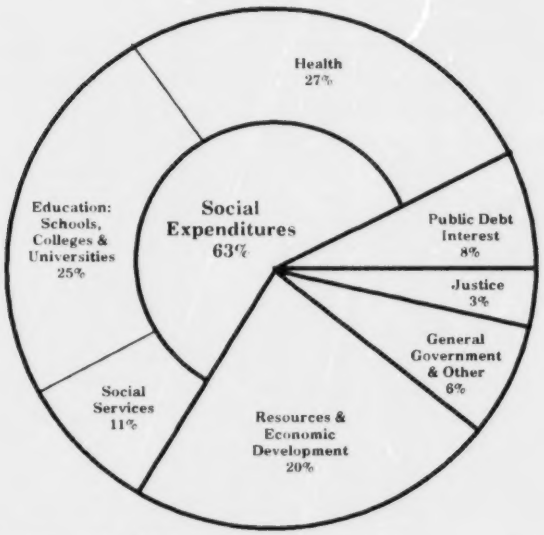
Provincial spending in support of resources and economic development will represent 17 per cent of Ontario's expenditures. This portion includes funding for the maintenance and construction of the transportation system, forest management programs, industrial and agricultural assistance programs, environmental protection and skills training.

Expenditures to support the administration of justice, the operation of Government and the Legislature will together account for 7 per cent. Interest payments on the public debt will represent another 11 per cent of Provincial spending this year.

* All Ontario Expenditure figures for 1987-88 are based on the September 30, 1987, Ontario Finances.

The distribution of Ontario's expenditures has changed since 1977-78. The key components are shown in the following graph.

DISTRIBUTION OF ONTARIO'S EXPENDITURES
1977-78



Source: Ontario Ministry of Treasury and Economics.

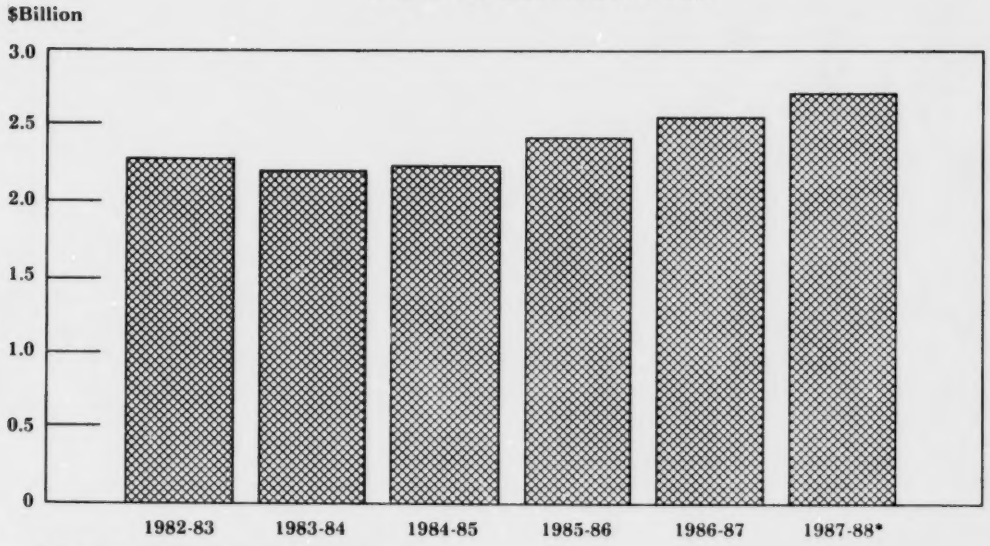
Expenditure on the Health, Social Services, Public Debt Interest components have increased as a proportion of the total spending while that of Education, Resources and Economic Development has declined since 1977-78.

Capital Expenditures

The Provincial Government directly, or indirectly through transfer payments, will provide $2.7 billion for capital investments in 1987-88. Capital expenditures support the construction of roads, water and sewage facilities, hospitals, day nurseries and educational facilities. Also included is the purchase of transit equipment and joint capital projects with private industry.

During the six-year period from 1982-83 to 1987-88 capital spending ranged between $2.2 billion and $2.7 billion.

CAPITAL EXPENDITURES



* Forecast as at September 30, 1987
Source: Ontario Ministry of Treasury and Economics.

Fiscal Performance

Ontario's fiscal performance will be measured in terms of a number of the commonly used indicators. A 10 year review of Selected Financial and Economic Statistics can be found in the Appendix.

Net Cash Requirements

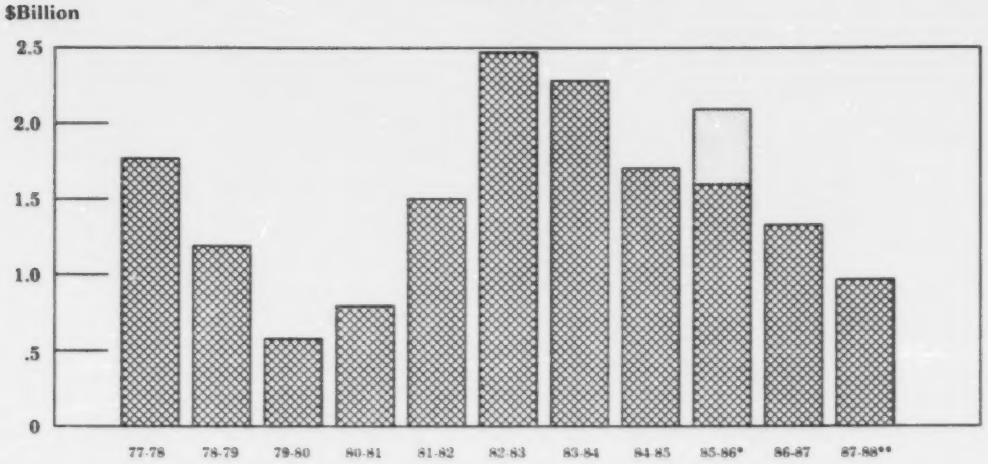
Net cash requirements (NCR) represent the shortfall between total revenues and total expenditures. Ontario's net cash requirement levels are a reflection of overall economic performance, stabilization policies and total spending.

Beginning in 1977, Ontario's net cash requirements experienced a downward trend which resulted in a low of $0.6 billion in 1979-80. In the early 1980's, a deterioration of world economic conditions had an adverse impact on Provincial finances, eventually leading to net cash requirements of almost $2.5 billion in 1982-83. In that fiscal year, net cash requirements as a proportion of total Provincial spending rose to 10.8 per cent, up from the 1979-80 proportion of 3.7 per cent.

Net cash requirements in 1987-88, at slightly less than $1.0 billion, are projected to be $1.5 billion less than the 1982-83 peak. As well, net cash requirements are expected to decline to 2.8 per cent of total spending.

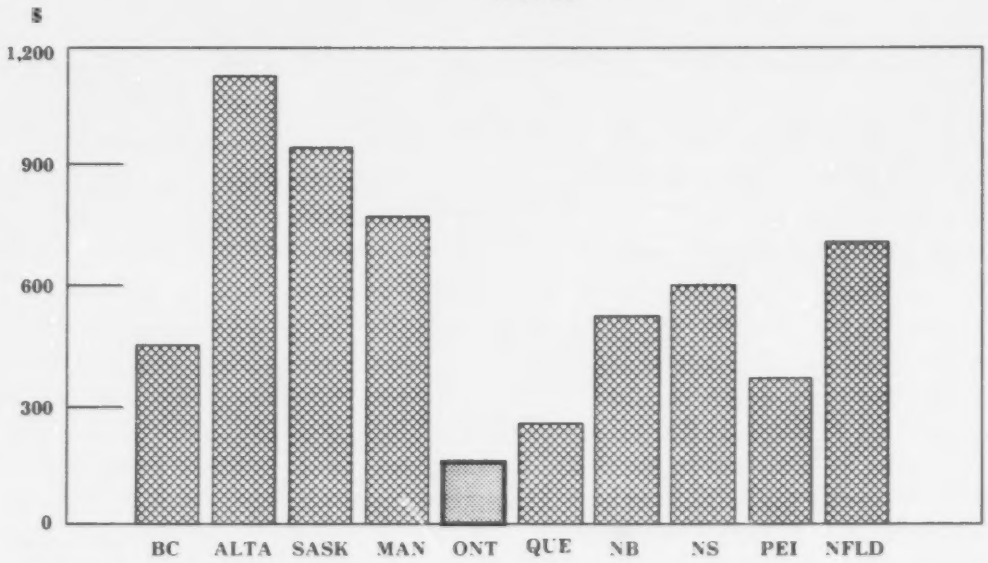
Ontario's net cash requirements per capita, at $106, are estimated to be the lowest among the provinces in 1987-88. It should be noted that this comparison has certain limitations in that financing for Crown corporations, public service pension funds and health insurance programs are treated differently by several provinces.

ONTARIO'S NET CASH REQUIREMENTS (NCR)
1977-78 to 1987-88



*Note: The shaded area represents NCR after extraordinary adjustments.
** Revised forecast as at September 30, 1987
Source: Ontario Ministry of Treasury and Economics.

NET CASH REQUIREMENTS PER CAPITA
1987-88*

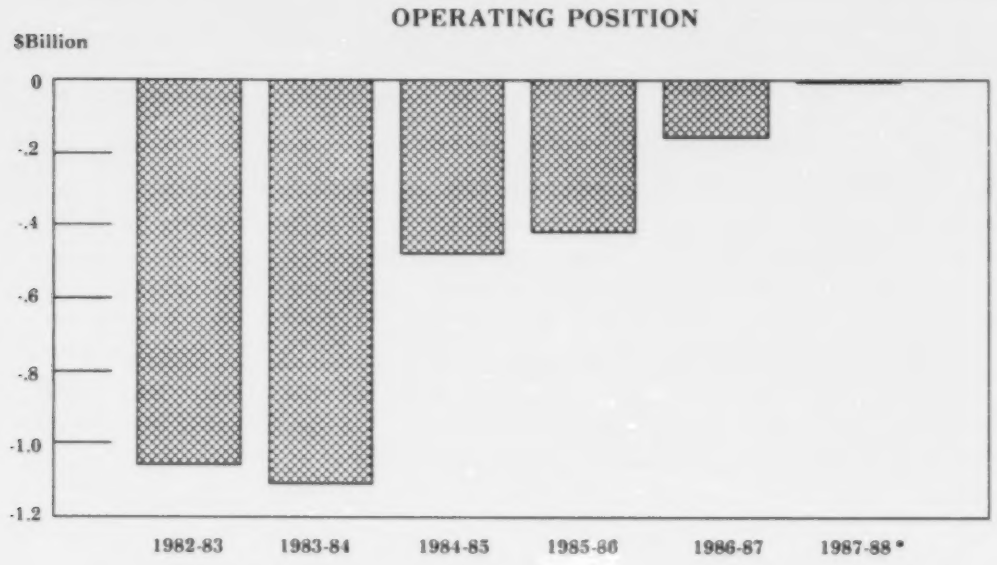


*** Forecast as at September 30, 1987**
Source: Ontario Ministry of Treasury and Economics.

Operating Position

The operating position is the difference between total current revenues and total current expenditures excluding capital expenditures. The operating position reflects the degree to which the Province pays for its day-to-day operating needs from its current revenues.

Ontario's operating position improved from a $1.1 billion operating deficit in 1982-83 to $0.2 billion in 1986-87, and is forecast to improve further to $15 million in 1987-88.



* Forecast as at September 30, 1987
Source: Ministry of Treasury and Economics.

Total Debt as a Per Cent of Gross Domestic Product

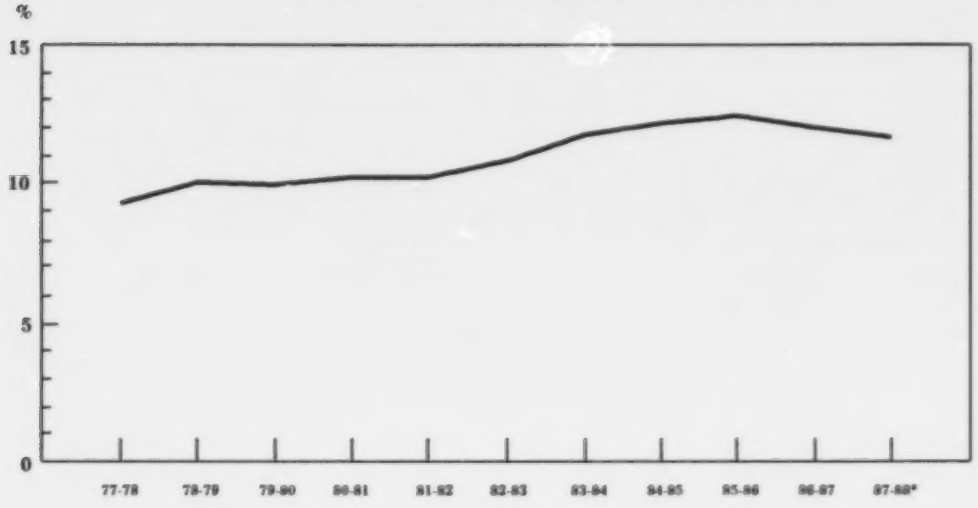
Ontario's total debt comprises funded and unfunded debt. Funded debt has a specified term to maturity and is secured by a debt instrument such as a bond or Treasury Bill. Unfunded debt is not secured by debt instruments.

The capacity of a government to carry its debt is largely determined by the underlying strength of the economy and tax revenues. The ratio of total debt to GDP rose to 17.8 per cent in 1978-79 and then fell to 16.2 per cent in 1981-82. It increased to 18.1 per cent in 1983-84 but is forecast to fall to 16.8 per cent in 1987-88.

Public Debt Interest

Public debt interest (PDI) costs for servicing total debt absorbed an increasing share of budgetary revenues until 1985-86. Public debt interest costs grew from 9.3 per cent of budgetary revenues in 1977-78 to 12.4 per cent in 1985-86. Thereafter, public debt interest costs fell to 12.0 per cent of budgetary revenues in 1986-87. In 1987-88, public debt interest costs are expected to fall further to 11.7 per cent of budgetary revenues.

PDI AS A PER CENT OF BUDGETARY REVENUE

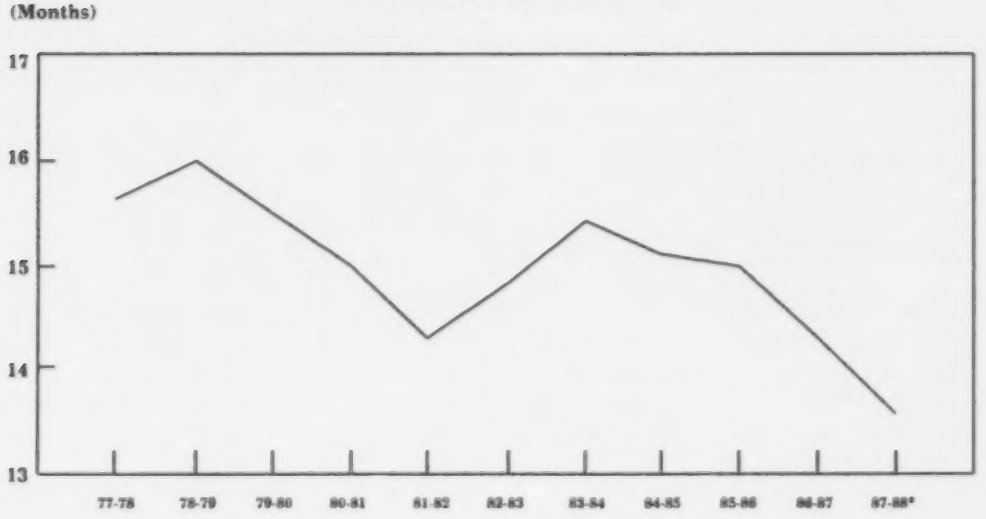


*** Forecast as at September 30, 1987**
Source: Ontario Ministry of Treasury and Economics.

Months of Budgetary Revenue Required to Repay Total Debt

Since 1977-78, the number of months of budgetary revenue required to repay total debt has ranged from a high of 16.0 months in 1978-79 to a low of 14.3 months in 1986-87. It would take an estimated 13.6 months of budgetary revenue to repay total debt in 1987-88.

MONTHS OF BUDGETARY REVENUE TO REPAY TOTAL DEBT



*** Forecast as at September 30, 1987**
Source: Ministry of Treasury and Economics

Fiscal Capacity and Tax Effort

Fiscal capacity measures the relative ability of a province to raise revenues from available revenue sources. Tax effort measures the relative extent to which each province taxes those available revenue sources. In this section, these measures are used to make interprovincial comparisons.

Determination of Fiscal Capacity

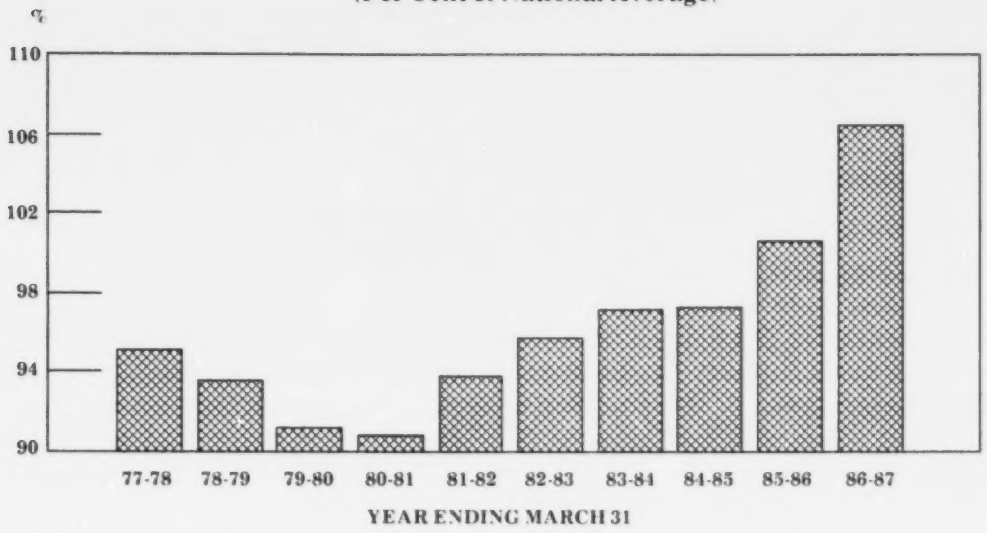
Fiscal capacity can be measured by a number of different indices.

The Representative Tax System (RTS) is the one used by the federal and provincial governments as a measurement of fiscal capacity. In the Representative Tax System, each revenue source has an associated tax base and the fiscal capacity can be related to population. For example, the base for tobacco taxes is the number of cigarettes sold in a province. If a province's share of a base is lower than its population share, that province is said to have a fiscal capacity deficiency in that tax base. If the opposite is true, a fiscal capacity surplus exists. In other words, a province has a fiscal capacity deficiency in a tax base if its per capita share of a base is less than the national average.

Tax bases are defined according to the taxing practices of provinces. For example, if an item such as infants' clothing is exempt from the retail sales tax in a majority of the provinces, such sales would not be included in the tax base. Hence, the term "representative".

Employing data from the federal equalization program, it is possible to derive an aggregate tax base share by "adding" together 37 different provincial and local tax bases. This provides a single but comprehensive measure of a province's relative fiscal capacity. In 1986-87, Ontario's fiscal capacity, measured on this basis for provincial own-source revenues, was 106.5 per cent of the national average. The chart below indicates how Ontario's fiscal capacity has varied over the past ten years. The range of fiscal capacities in 1986-87 was 60.9 per cent for Newfoundland to 155.4 per cent for Alberta.

FISCAL CAPACITY OF ONTARIO
(Per Cent of National Average)



Source: Department of Finance, Canada and Ontario Ministry of Treasury and Economics.

As Table 3 shows, if federal transfer revenues are added to provincial-local own-source revenues, the fiscal capacity of "have-not" provinces approaches the national average. Since federal transfers are relatively greater for the "have-not" provinces, the relative fiscal capacities of the "have" provinces decline. For example, Ontario's 1986-87 fiscal capacity declines about 8.0 percentage points to 98.4 per cent of the national average, primarily because the Province does not receive federal equalization payments.

Indices of Provincial-Local Fiscal Capacity, 1986-87 **Table 3**

(Per Cent of National Average)

	Provincial-Local Own-Source Revenues	Provincial-Local Own-Source Revenues plus All Federal Transfers
Newfoundland	60.9	94.0
Prince Edward Island	63.2	98.1
Nova Scotia	75.0	94.9
New Brunswick	70.5	97.3
Quebec	84.2	92.4
Ontario	**106.5**	**98.4**
Manitoba	84.5	92.9
Saskatchewan	92.1	94.1
Alberta	155.4	138.5
British Columbia	102.8	99.0
National Average	100.0	100.0

Source: Department of Finance, Canada.

Included in the determination of federal transfers are special contracting-out tax points that Quebec opted for in lieu of a portion of federal cash contributions under the Canada Assistance Plan and Hospital Insurance. The latter contributions were subsequently rolled into Established Programs Financing.

Determination of Tax Effort

A comparison of provincial tax rates on individual revenue sources is often employed as a gauge of relative revenue-raising efforts. However, such comparisons alone do not provide a way of assessing a province's overall tax effort.

As with the determination of fiscal capacity, tax effort can be measured by individual revenue sources. For each revenue source, a national average tax rate can be calculated by dividing the provincial revenues collected by the total all-province tax base.

A comprehensive measure of tax effort can be calculated by dividing a province's share of total provincial-local revenues by its share of total tax base. In order to determine a province's share of the aggregate tax base, each of the revenue sources must be weighted to reflect the relative importance that is attached to them individually. For example, if personal income tax (PIT) revenues account for 27 per cent of the total ten-province revenues, the weight of personal income tax in the comprehensive tax base would be 27 per cent. Each province's share of this weighted tax base is calculated by multiplying its percentage share of the personal income tax base by this weighted percentage. In the case of Ontario, the Province's share of the personal income tax base, 39 per cent, is multiplied by the weighted personal income tax base of 27 per cent to derive Ontario's percentage share of the personal income tax portion of the comprehensive tax base (i.e., 10.5 per cent). Ontario's share of the comprehensive tax base is determined by summing together the individual percentage shares of the 37 revenue source comprehensive tax base components.

This measure of tax effort indicates to what extent a province is taxing what is available to be taxed, relative to the national average. Local revenues are included because of the varying responsibilities that individual provinces allocate to their local governments. Table 4 provides the indices of relative tax effort for 1986-87 on this comprehensive basis.

Indices of Provincial-Local Tax Effort, 1986-87 **Table 4**
(Per Cent of National Average)

Newfoundland	107.0
Prince Edward Island	93.6
Nova Scotia	98.2
New Brunswick	99.8
Quebec	126.1
Ontario	**104.6**
Manitoba	106.0
Saskatchewan	96.8
Alberta	68.2
British Columbia	99.8
National Average	100.0

Source: Department of Finance, Canada.

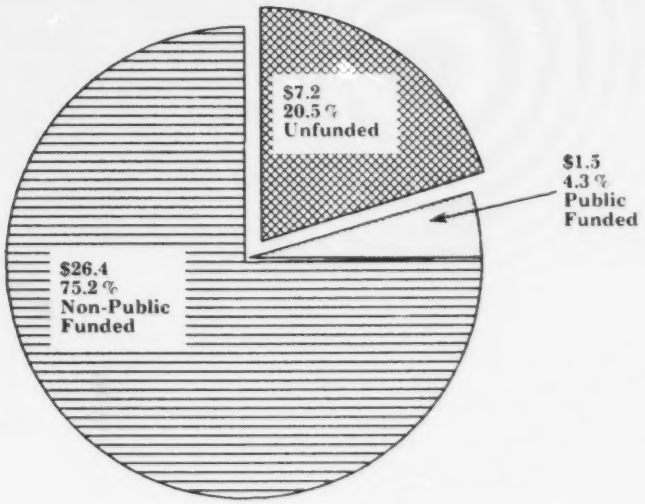
Ontario's overall tax effort slightly exceeds the national average. Alberta's tax effort is about 32 per cent below the national average, mainly because it levies no sales or gasoline tax, and has the lowest personal income tax. Since Alberta's share of oil and gas revenues is about the same as its share of oil and gas tax bases, its resource taxation does not bias its tax effort one way or another.

Quebec has a very high tax effort, some 26 percentage points above the national average in 1986-87. Despite high rates of taxation on certain revenue sources, the Maritime provinces do not have a high degree of overall tax effort, due in large part to their relatively low levels of local property taxation.

Debt and Debt Financing*

Ontario's Debt

COMPOSITION OF ONTARIO'S OWN-PURPOSE TOTAL DEBT
March 31, 1987
($Billion)



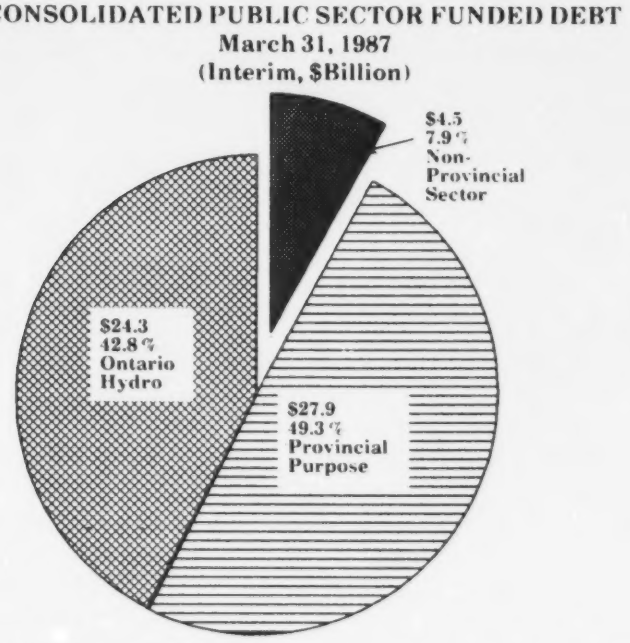
Source: Ontario Ministry of Treasury and Economics.

Ontario's own-purpose total debt consists of funded and unfunded debt. Funded debt, the largest portion, has a specified term to maturity and is secured by a debt instrument such as a bond or Treasury Bill. Ontario's funded debt is concentrated in non-public debt, owed primarily to the Canada Pension Plan (CPP) and the Teachers' Superannuation Fund (TSF) in the form of long-term, non-marketable securities at market-related rates of interest. Debt owed to the general public is about 4.0 per cent of the Province's total debt. The Province's estimated funded debt at March 31, 1988 will be $29 billion of which about 90 per cent will be owed to the CPP and TSF.

Unfunded debt refers to obligations that are not secured by a debt instrument such as deposits with the Province of Ontario Savings Office and for the Public Service Superannuation Fund. Unfunded debt represents 20.5 per cent of Ontario's total debt, up from about 15 per cent ten years ago. Ontario's own-purpose total debt will be about $37 billion by the end of fiscal 1987-88 compared to $16.5 billion ten years ago.

* All Ontario debt figures for 1987-88 are based on the September 30, 1987 Ontario Finances.

Consolidated Public Sector Funded Debt



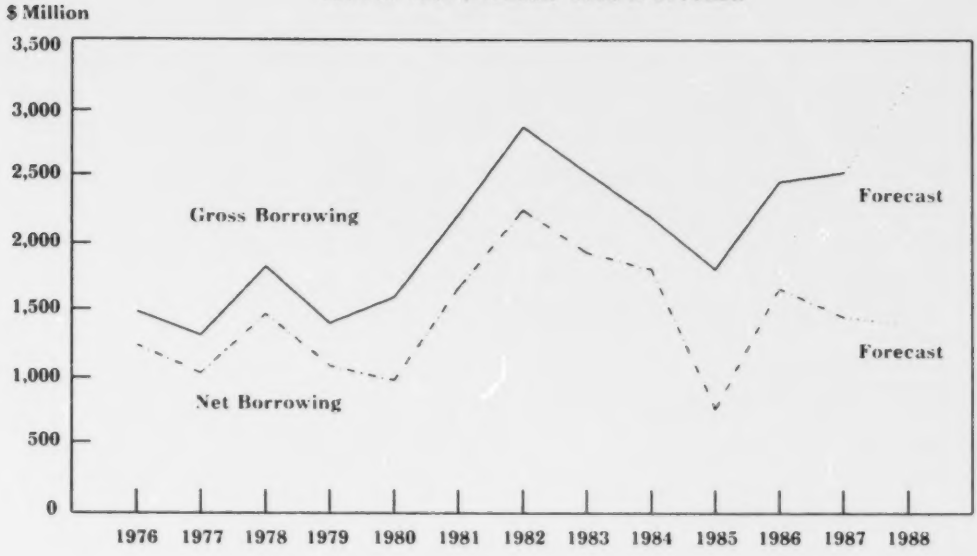
Source: Ontario Ministry of Tresury and Economics.

The broadest measure of funded debt in the Ontario Public Sector is Consolidated Public Sector Funded Debt which includes debt incurred at all levels of Provincial jurisdictions. The preponderance of Provincial and Provincially guaranteed debt in this measure illustrates Ontario's policy of centralizing public sector financing at the Provincial level. Ontario's direct and guaranteed funded debt, which is over 90 per cent of the consolidated debt, consists of obligations for the Province's own purpose or for Ontario Hydro. Due to Ontario's policy of centralized financing, there is a limited requirement for public borrowing by local bodies, colleges and hospitals. Internal funds and Provincial grants finance a large proportion of local capital expenditures, with the remainder financed by borrowing. Local government debt is 5.0 per cent of consolidated funded debt while less than one-half of one percent consists of the obligations of universities, colleges and hospitals. The Provincial (direct and guaranteed) share of Consolidated Public Sector Funded Debt has been rising over time reflecting the policy of centralized financing.

Hydro Borrowing

In 1987 and 1988, Ontario Hydro's annual gross borrowing is expected to be around $2.5 and $3.2 billion respectively, with borrowing net of retirements amounting to $1.4 billion in both 1987 and 1988. The higher gross figure for 1988 is due largely to the proposed call and refinancing of three high interest cost issues. Even though it is unlikely that Hydro's gross borrowing needs will put undue pressure on the capital markets, the Province will

ONTARIO HYDRO BORROWING
1976 to 1987 (Actual) 1988 (Forecast)

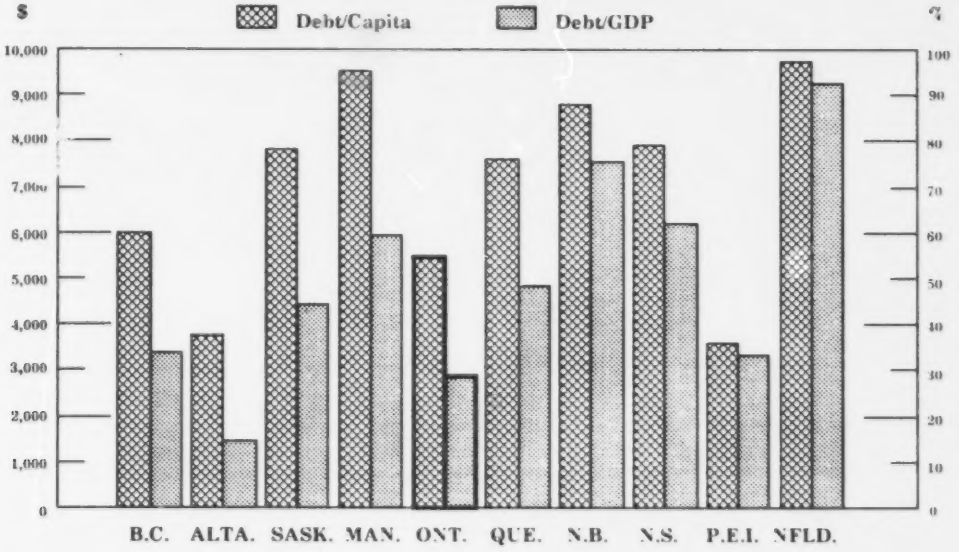


Source: Ontario Hydro.

continue to monitor Hydro's financing needs and plans to ensure that they are consistent with the Province's fiscal and financial plans.

Interprovincial Comparisons

INTERPROVINCIAL FUNDED DEBT COMPARISONS
December 1986



Source: Bank of Canada Review.

Interjurisdictional debt comparisons usually focus on funded debt measures because this assures a standard of conceptual uniformity and comparability across jurisdictions and over time. Similarly, in order to avoid the

inconsistencies caused by provinces assuming different types of debt at different levels of the public sector, the sum of funded debt owed by a province and debt guaranteed by a province is used in interprovincial comparisons. Nevertheless, the comparisons remain limited by differences in treatment across provinces of sinking funds and purchases by public sector investment funds such as the Alberta Heritage Savings Trust Fund.

Ontario's direct and guaranteed debt burden is relatively low compared to other provinces. In 1986, Ontario owed $5,544 per person. This was the third lowest level of direct and guaranteed debt per capita in Canada, higher only than Prince Edward Island and Alberta. Ontario had the second lowest level of debt as a per cent of Gross Domestic Product (29 per cent), after Alberta.

Ontario's Financing

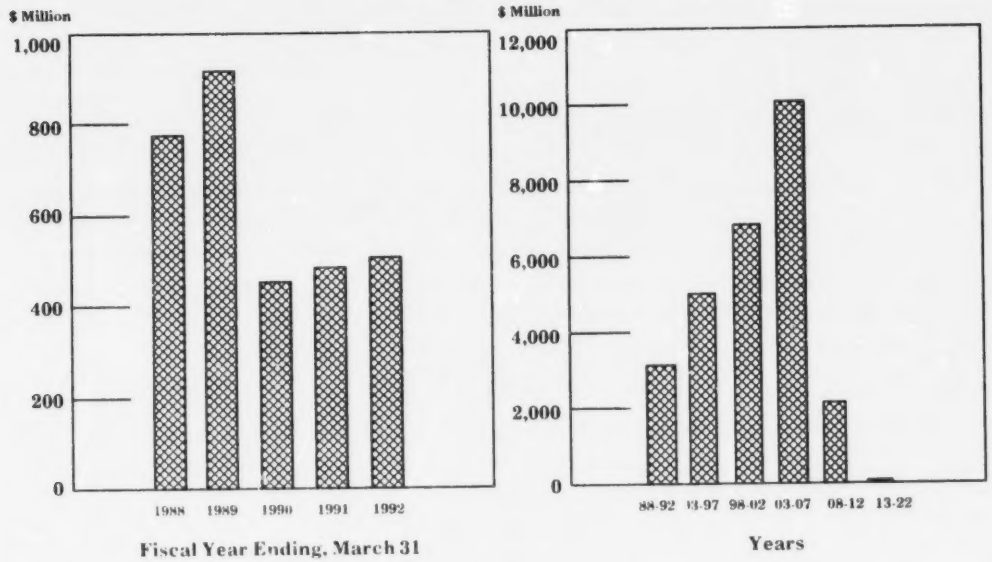
The Province of Ontario has available for its financing purposes the funds of the Teachers' Superannuation Fund (TSF) and Ontario's share of the Canada Pension Plan (CPP) as well as domestic and international capital markets. Because of the structure of contributions and benefits of these two pension plans, they have been a growing source of financing for Ontario. In 1987-88, non-public availability exceeds the Province's needs and consequently, Ontario has declined most of the CPP funds available to it.

Ontario's Maturing Debt

Approximately 11.5 per cent of Ontario's funded debt (excluding Treasury Bills) is scheduled to mature in the five-year period from April 1987 to March 1992 and 30 per cent in the ten years from 1988 to 1997.

In the five year period ending March 1992, maturities (excluding Treasury Bills) will total $3.1 billion, with 70 per cent representing retirements of Canada Pension Plan obligations.

ONTARIO DEBT MATURITY



Source: Ontario Ministry of Treasury and Economics.

Credit Worthiness

Provincial Ratings
October 1987

Table 5

	Standard and Poor's (S&P)	Moody's	Canadian Bond Rating Service (CBRS)	Dominion Bond Rating Service (DBRS)
British Columbia	AA	Aa2	AA	AA (low)
Alberta	AA+	Aa1	AA	AA
Saskatchewan	AA-	A1	AA-	A (high)
Manitoba	A+	A1	AA-	A
Ontario	AA+	Aaa	AAA	AA
Quebec	AA-	Aa3	A	A (high)
New Brunswick	A+	A1	A	A
Nova Scotia	A-	A2	A-	A (low)
Prince Edward Island	NR*	A3	BBB+	A (low)
Newfoundland	A-	Baa1	BBB	BBB

* Not Rated.

Source: Ontario Ministry of Treasury and Economics, Canadian Bond Rating Service, Dominion Bond Rating Service, Moody's Bond Survey and Standard and Poor's CreditWeek.

The 1980s have been a period of general pressure on Canadian provincial credit ratings. In 1986 and 1987 to date, four provinces have been downgraded by Standard and Poor's, Moody's (two U.S. rating agencies) or by the Canadian Bond Rating Service because their economic performance has been weak or their fiscal and financial performance has not matched their economic improvements.

In mid-1986, Ontario was upgraded by the Canadian Bond Rating Service to an unqualified AAA from AAA-. In addition, Moody's raised Quebec to Aa3 from A1 and New Brunswick to A1 from A2.

Dominion Bond Rating Service started rating the Canadian provinces in 1987. Ontario and Alberta received AA, the highest rating of all provinces.

Rating Adjustments in 1986 and 1987 **Table 6**

		Rating Change
British Columbia	Downgraded from:	Aa1 to Aa2 (Moody's)
Alberta	Downgraded from:	Aaa to Aa1 (Moody's) AAA to AA + (S&P) AAA to AA (CBRS)
Saskatchewan	Downgraded from:	AA to AA- (S&P) Aa3 to A1 (Moody's) AA to AA- (CBRS)
Manitoba	Downgraded from:	AA- to A + (S&P)
Ontario	Upgraded from:	AAA- to AAA (CBRS)
Quebec	Upgraded from:	A1 to Aa3 (Moody's)
New Brunswick	Upgraded from:	A2 to A1 (Moody's)

Source: Ontario Ministry of Treasury and Economics, Canadian Bond Rating Service, Moody's Bond Survey and Standard and Poor's CreditWeek.

Federal-Provincial Funding Programs

The following sections describe the two major programs through which the Province receives substantial federal funding: the fiscal arrangements and the Canada Assistance Plan.

Federal-Provincial Fiscal Arrangements

Introduction

The federal-provincial fiscal arrangements are the institutional vehicles through which the federal government transfers funds to the provinces as part of its historical commitment to certain national shared-cost programs, and to the principle of interprovincial fiscal capacity equalization. The largest of these payments is made in respect of health care and post-secondary education under Established Programs Financing. Funds are also transferred under the Equalization program, the Fiscal Stabilization program, and the Personal Income Tax Revenue Guarantee.

Although often discussed in terms of federal-provincial negotiation and agreement, it should be noted that the fiscal arrangements are under the sole legislative and administrative control of the federal government. Every five years, legislation in this area is drafted and enacted by the federal government, and requires no provincial enabling legislation, support or

even agreement to operate. In practice, however, Ottawa has consulted with the provinces on potential revisions to the legislation prior to enactment.

Established Programs Financing

Adopted in 1977 to replace the federal-provincial shared-cost programs in the fields of health and post-secondary education, Established Programs Financing was regarded as a milestone in co-operative federalism in Canada. The essence of the new arrangement was that the provinces, long dissatisfied with the cumbersome and inflexible nature of the cost-sharing arrangements, were given greater policy and administrative latitude through a move to block funding. At the same time, Ottawa lessened its financial risk by tying its contributions to the rate of growth of the national economy rather than to provincial expenditures.

At a Conference of First Ministers held in June 1976, the broad framework for Established Programs Financing was introduced. At that time, the Prime Minister outlined five principles that would form the basis of the federal approach*:

- The federal government should continue to pay a substantial share of program costs.
- The federal payment should be calculated independently of provincial program expenditures.
- There should be greater equality, in per capita terms, in the federal contributions to the provinces.
- The arrangements for the mature programs should be placed on a more permanent footing.
- There should be provision for continuing federal participation in the development of policies of "national significance" in health and post-secondary education.

The Prime Minister also emphasized that the federal government intended to encourage provincial spending restraint through the new arrangement.

There was widespread provincial acceptance of most of these principles, and a federal-provincial consensus on the course that was being charted. However, shortly after the new arrangement had been agreed upon, the federal government decided to keep track of the individual cash components of the transfers for health and post-secondary education. While not consistent with the principle of block funding, the split was for federal bookkeeping purposes only and did not require provinces to demonstrate that they had, in fact, spent the funds in these areas.

The Canada Health Act illustrates the federal government's attempts to "reconditionalize" Established Programs Financing. Passed by Parliament

* Statement tabled by the Prime Minister of Canada, the Right Honourable Pierre Elliott Trudeau, on the occasion of the Conference of Federal and Provincial First Ministers, held in Ottawa, June 14 and 15, 1976.

in 1984, the Act sets program criteria and conditions of payment for the cash portion of transfers paid to the provinces for insured health-care services and extended health care. Under the terms of the legislation, each province's health insurance plan must satisfy federal requirements respecting comprehensiveness, portability, universality, accessibility and public administration.

The federal government is empowered to withhold a portion of the provincial transfer payments equal to the amount that physicians bill above the rates set out in the provincial fee schedules. Dollar for dollar deductions are also imposed on provinces which permit user charges. Between July 1984 and June 1986, over $106 million in payments to Ontario were withheld by the federal government. The Province has since complied with the conditions of the Canada Health Act by eliminating extra-billing for insured health services, and has recouped the amount withheld.

As shown in Table 7, the federal government has taken a number of further actions to restrain the growth of its payments to the provinces. When the fiscal arrangements were amended in 1982, the Revenue Guarantee Compensation, which was built into Established Programs Financing as part of the 1977 agreement, was removed. This effectively eliminated a portion of the per capita entitlements.

Established Programs Financing transfer growth is based on both growth in the economy and population increases for individual provinces. Under the two-year federal "6 & 5" restraint program introduced in June 1982, per capita limits were imposed on post-secondary education transfer growth.

Most recently, the federal government's Bill C-96, An Act to Amend the Federal-Provincial Fiscal Arrangements and Federal Post-Secondary Education and Health Contributions Act, 1977, received Royal Assent in June 1986. It reduces the annual growth in per capita Established Programs Financing transfers by two percentage points. In 1987-88, Bill C-96 will reduce Ontario's Established Programs Financing entitlements by $250 million. Taken together, the reductions in Established Programs Financing entitlements for Ontario amount to $812 million in 1987-88.

Provincial Losses Due To Federal EPF Cuts Since 1982 **Table 7**
($ Million)

	Elimination of Revenue Guarantee Compensation		"6 & 5" Caps on Post-Secondary Education Transfers		Reduction of EPF Escalator	
	Ontario	All Provinces	Ontario	All Provinces	Ontario	All Provinces
1982-83	294	830	-	-	-	-
1983-84	325	917	44	125	-	-
1984-85	356	1,002	95	264	-	-
1985-86	384	1,076	102	286	-	-
1986-87	413	1,159	110	308	114	317
1987-88	444	1,243	118	330	250	678
TOTAL	2,216	6,227	469	1,313	364	995

Source: Department of Finance, Canada and Ontario Ministry of Treasury and Economics.

Federal support for Ontario health and post-secondary education programs has fallen from a peak of 52 per cent of provincial-local spending for these purposes in 1979-80, to about 40 per cent in 1986-87. Since Established Programs Financing tax point transfers are derived from provincial taxpayers, they can be regarded as provincial revenues. Thus, if the federal contribution is considered solely in terms of the Established Programs Financing cash component, then Ottawa's current share of combined health and post-secondary education spending in Ontario would amount to only 22 per cent, down from 30 per cent in 1979-80.

Equalization

Equalization payments are unconditional transfers from the federal government to qualifying provinces, with the purpose, as enshrined in Section 36 of the Constitution Act, 1982, of ensuring that provincial governments have sufficient revenues to provide "reasonably comparable levels of public services at reasonably comparable levels of taxation". The actual determination of equalization entitlements has evolved over the years by refinements and adjustments to the formula since the inception of the program in 1957. Although there have been disagreements about these changes, some of which had quite dramatic effects, all provinces have supported the overall thrust of the program.

Ontario has never been an equalization recipient. Indeed, when oil price shocks created the possibility of Ontario receiving equalization payments, these equalization payments were prevented through retroactive legislative amendment in 1981.

Determining the extent to which the goals of equalization are being achieved is difficult due to the lack of a definition or measure of "reasonably

comparable levels of public services at reasonably comparable levels of taxation". As was discussed in the section on fiscal capacity and tax effort, the equalization program takes into account 37 distinct revenue sources. These sources and the estimated provincial revenues to be equalized for 1987-88 are summarized in Table 8.

Fiscal Equalization, 1987-88 **Table 8**
($ Billion)

Revenue Source	Amounts Subject to Equalization
Personal Income Tax Revenues	25.9
Business Income Revenues	5.0
Capital Tax Revenues	1.3
General and Miscellaneous Sales Taxes	14.6
Tobacco Taxes	2.1
Gasoline Taxes	3.0
Diesel Fuel Taxes	0.8
Non-Commercial Vehicle Licences	1.3
Commercial Vehicle Licences	0.5
Revenues from the Sale of Spirits	1.5
Revenues from the Sale of Wine	0.5
Revenues from the Sale of Beer	0.8
Hospital and Medical Insurance Premiums	2.3
Race Track Taxes	0.1
Natural Resource Revenues **	3.5
Insurance Premium Revenues	0.5
Payroll Taxes	2.1
Provincial-Local Property Tax Revenues	17.6
Lottery Revenues	1.2
Miscellaneous Provincial-Local Taxes and Revenues	7.5
Shared Revenues: Off-shore Activities	*
TOTAL	92.2

Notes: * Less than $50 million.
** The separate natural resource revenue sources have been aggregated.

Source: Department of Finance, Canada: Provincial Fiscal Equalization, Second Estimate, 1987-88 (July, 1987).

This set of revenue sources is known as the Representative Tax System (RTS), since it attempts to take into consideration what provinces as a whole actually tax. Each of the revenue sources has an associated tax base. For example, the base for revenues from the sale of beer is the volume of beer sold.

The tax bases have been modified over the years. Discussions continue on technical problems that are perceived to remain in the determination of appropriate components to use in some tax bases to satisfy the requirement of making them "representative". For example, there is currently a debate on the property tax base: since there is no comparable interprovincial property tax base, the equalization formula has had to rely on proxies for the assessed values of land and buildings.

For each revenue source, a national average tax rate is calculated by dividing the total revenues to be equalized by the total all-province tax base.

Comparisons can be made among provinces by applying the national average tax rate for each revenue source to individual provincial tax base values on a per capita basis.

The equal yield per capita standard that the equalization formula sets must then be determined.

The current benchmark that is applied to each province for each revenue source is termed the "five-province standard"; this standard is derived by applying the national average tax rate to the tax bases of Quebec, Ontario, Manitoba, Saskatchewan and British Columbia and calculating the per capita yield for the five provinces.

Finally, the difference between this standard per capita yield and a province's own per capita yield provides its relative per capita deficiency or surplus for each of the 37 sources.

Two examples illustrate this process:

- In calculating the latest estimate for 1987-88 national average tax rates, the Newfoundland personal income tax base yields $525.71 per capita. The national average tax rate applied to the five-province standard tax base yields $1,033.45 per capita. This means that Newfoundland has a personal income tax deficiency of $507.74 per capita ($1,033.45 - 525.71). Newfoundland's equalization component in respect of personal income tax, $289 million, is then calculated by multiplying its per capita deficiency by its population.
- Conversely, Ontario's yield at the national average tax rate is $1,198.44 per capita. Since this yield is above the $1,033.45 per capita that results from applying the national average tax rate to the five-province standard, Ontario has a personal income tax surplus of $164.99 per capita.

The calculation of a deficiency for a province for a particular revenue source does not necessarily mean that the province will receive equalization payments. The size of equalization entitlements is determined by the netting of all negative and positive entitlements. In Ontario's case, for example, although the formula indicates a deficiency in the oil and gas revenue sources, negative entitlements in other sources are sufficiently large to negate entitlement to equalization on an aggregate basis.

The current "five-province standard" replaced a national average standard in 1982. This change, combined with a number of tax base modifications, tended to disadvantage Quebec and Manitoba. Accordingly, a three-year transitional guarantee was incorporated into the formula.

The transitional guarantee provided that no province could receive less under the new formula than it received in the last year of the old formula. Provision was made for a specified amount of growth.

This provision lapsed at the end of the 1984-85 fiscal year, at an estimated three-year cost to the federal government of $2.1 billion. All equalization recipients received transitional guarantee payments.

As shown in Table 9, following the lapse of the transitional program, additional supplementary equalization payments totalling $220 million were made to the six recipient provinces in respect of the 1985-86 fiscal year. One year later, Manitoba received an additional $65 million in supplementary equalization.

Supplementary Equalization Payments **Table 9**
($ Million)

	1985-86	1986-87
Newfoundland	15	-
Prince Edward Island	5	-
Nova Scotia	20	-
New Brunswick	20	-
Quebec	110	-
Manitoba	50	65
TOTAL	220	65

Source: Department of Finance, Canada.

The sole legislative constraint on the growth of equalization entitlements is that aggregate transfers must not exceed the year-over-year increase in Gross National Product (GNP). So far, this ceiling has not had to be applied.

For 1987-88, the current estimate of equalization entitlements is $5.9 billion. Although Quebec receives the greatest share of total equalization, on a per capita basis it receives the second least. Table 10 shows the breakdown of the estimated 1987-88 entitlements among the provinces as well as the entitlements on a per capita basis.

Estimated Equalization Entitlements by Province, 1987-88 **Table 10**

	($ Million)	($ Per Capita)
Newfoundland	754	1,322
Prince Edward Island	156	1,221
Nova Scotia	681	776
New Brunswick	699	977
Quebec	2,983	453
Manitoba	506	469
Saskatchewan	153	150
TOTAL	5,931	540

Note: Ontario, Alberta and British Columbia have net negative entitlements and do not receive equalization payments.

Source: Department of Finance,Canada: Provincial Fiscal Equalization, Second Estimate, 1987-88 (July, 1987).

Fiscal Stabilization

In order to protect provinces from sudden year-over-year losses in revenue resulting from an economic downturn, the federal government has provided for fiscal stabilization payments. These unconditional cash transfers ensure that each province's tax revenues, measured on the basis of constant tax rates and structure, plus its equalization payments, will not be less than they were in the previous year.

In 1987-88, the federal government introduced, among other technical changes, an annual ceiling of $60 per capita for grant assistance. Entitlements exceeding this limit will be provided as interest-free loans repayable within five years.

To date, only one province has received payments under this program -- British Columbia received $175 million in respect of the 1982-83 fiscal year. However, fiscal stabilization payments provide an important guarantee for many provinces when their credit ratings are under review.

Personal Income Tax Revenue Guarantee

Provincial Personal Income Tax Revenue Guarantee payments ensure that provinces will not suffer a reduction in personal income tax revenues due to amendments to the federal Income Tax Act. Should federal actions reduce a province's personal income tax revenues by more than 1.0 per cent from the preceding year, that province becomes eligible for a federal revenue guarantee payment. The amount of the payment would be the difference, exceeding 1.0 per cent, between the amount of tax which would have been raised under the federal legislation prior to amendment and the amount raised subsequent to amendment.

Canada Assistance Plan

The Canada Assistance Plan (CAP) was established by federal legislation in 1966 as a cost-sharing mechanism for provincially-administered social assistance and welfare programs. The Canada Assistance Plan replaced the targetted shared-cost programs which provided assistance for the elderly, the blind, the disabled and the unemployed. By the end of the 1960s, these programs had come under increasing criticism for their eligibility restrictions. The new program was designed to bring a measure of order and coherence to fragmented provincial public assistance systems.

Since its inception, payments under the Canada Assistance Plan have grown dramatically, increasing from $343 million in 1967-68 to an estimated $4.2 billion in 1987-88. This makes the Canada Assistance Plan the third largest source of transfers to the provinces after Established Programs Financing and equalization. In Ontario alone, Canada Assistance Plan payments are expected to exceed $1.2 billion for 1987-88.

The Canada Assistance Plan is intended to act as a last resort safety net. Under its provisions, the federal government contributes an amount equal to 50 per cent of provincial expenditures on assistance payments (food, shelter and clothing) to individuals in need, and a range of welfare services,

including child welfare, day care, homemaker services for the elderly, institutions for the disabled and family counselling. To qualify for federal Canada Assistance Plan funds, provincial programs must be designed to benefit those "in need or likely to become in need". As well, potential beneficiaries must demonstrate their eligibility through either a needs test or an income test, as determined by each province and subject to federal guidelines.

Although the Canada Assistance Plan stands out as a highly successful example of federal-provincial co-operation, the program has been the subject of numerous reviews during the last two decades. In 1970-71, the Senate Committee on Poverty issued a report that was critical of the Canada Assistance Plan and recommended that it be replaced by a guaranteed annual income. Ten years later, negotiations were underway to remove social services from the Canada Assistance Plan and provide them through a block fund under a proposed Social Services Financing Act modelled on Established Programs Financing. The proposal, however, was withdrawn when the provinces refused to accept a reduction in the Established Programs Financing escalator to GNP growth less one per cent. The proposal to replace the federal share of the Canada Assistance Plan and other federal tax and transfer programs, such as family allowances and child tax credits, with a guaranteed annual income, was resurrected by the Macdonald Commission in 1985 when it recommended the adoption of a Universal Income Security Program.

More recently, the Nielsen Task Force on Program Review found no support for a major revision of the Canada Assistance Plan. However, its report did register concern over the trend toward long-term dependence on assistance among "employables" and warned of the danger that future Canada Assistance Plan costs may become unaffordable as a result. The Nielsen review concluded that it may be necessary to change the open-ended nature of Canada Assistance Plan funding by limiting federal spending under the agreement. Increasingly, the limits inherent in the Canada Assistance Plan's welfare orientation are becoming more evident as priorities in the areas of child care and family violence are pushed to the foreground.

Provincial-Local Transfers

In 1987-88, the province will provide $3.9 billion in financial support to municipalities and municipal agencies, as indicated in Table 11.

Provincial support to school boards amounts to more than $3.8 billion, including nearly $150 million in capital assistance.

Highlights of Provincial Transfers to Local Governments — **Table 11**

($ Million)

	Outlook 1987-88
Transfers to Municipalities	
Unconditional	824
Roads	601
Transit	311
Social Services	1,251
Health	175
Environmental	136
Recreational & Cultural	86
Other	406
Ontario Municipal Improvement Fund	60
Total Municipal Transfers	3,850
Transfers to School Boards	
General Legislative Grants	3,609
Capital Grants	147
Total School Transfers	3,756
Total Transfers to Local Government	7,606

Source: Ontario Ministry of Treasury and Economics.

Transfers to Municipalities

Transfer payments to municipalities are estimated to increase by 10.9 per cent in 1987-88.

The average annual growth in Provincial support to the municipal sector has outpaced inflation since the beginning of the decade. As Table 12 indicates, total operating transfers increased faster than the rate of inflation, while the growth in capital transfers was lower than inflation, reflecting the fairly stable pattern of provincial capital activity in general.

Provincial Transfers to Municipalities **Table 12**
($ Million)

	1982-83	Outlook 1987-88	Average Annual Increase (%)
Unconditional	627	824	5.6
Conditional	1,146	1,934	11.0
Total Operating	1,773	2,758	9.2
Capital	898	1,032	2.8
Total Transfers	2,671	3,790	7.3
Ontario Municipal Improvement Fund	–	60	–
Enriched Total Transfers	2,671	3,850	7.6

Source: Ontario Ministry of Treasury and Economics.

Municipal Sector Performance

Municipal spending in 1987 is expected to grow by 8.8 per cent. This growth continues to be led by the areas served by regional governments, excluding Metro Toronto, which account for 39 per cent of municipal spending. These areas are generally experiencing above-average service growth as measured by the growth in households. It should also be noted that individual municipal patterns of growth within these areas can vary considerably. By comparison, Table 13 shows that for the rest of the province spending growth is expected to average around 7.8 per cent.

Estimated Municipal Spending, 1986 & 1987 **Table 13**
($ Million)

	1986	1987	Increase (%)
Metropolitan Toronto	3,404	3,687	8.3
Other Regional Governments	3,974	4,385	10.3
All Regional Governments	7,378	8,072	9.4
Cities Not Part of Regional Governments	1,471	1,567	6.5
All Other Municipalities	1,575	1,697	7.8
Non-Regional Governments	3,046	3,264	7.2
Total Municipal Sector	10,424	11,336	8.8

Source: Ontario Ministry of Municipal Affairs.

Since 1982, provincial transfers have almost kept pace with the growth in overall local spending. As shown in Table 14, the proportion of municipal financing accounted for by transfers has dropped slightly over the period, with the difference being made up by municipal property taxes.

Municipal Revenue Mix **Table 14**
(Per Cent)

	1982	1987
Property Taxation	34.8	36.7
Provincial Grants	31.8	30.0
All Other Revenues	33.3	33.3
	100.0*	100.0

* Totals may not add due to rounding

Source: Ontario Ministry of Municipal Affairs.

Since 1970, property tax burdens (taxes in relation to household incomes) have remained below the 3.0 per cent level, and are now approximately 2.4 per cent. However, over the past five years, overall mill rate increases (including school taxes) have outpaced the growth in both inflation and incomes. School taxes have contributed more to the recent rise in local taxation, growing 8.3 per cent for an average household on an annual basis since 1982, compared to 6.9 per cent annual growth in municipal taxes.

Education Finance

The funding of elementary and secondary education in Ontario is shared between the province and local school boards. The provincial share is distributed to school boards through the General Legislative Grants with the school board share being raised from local property taxes. School funding is a significant component of government spending at both levels, as shown in Table 15.

Education Finance in Perspective **Table 15**
(Per Cent)

	1987-88
Transfer Payments to School Boards	
Relative to Total Local Transfers	49.4
Relative to Provincial Budgetary Expenditure	10.8
School Finance in the Local Sector	
School Board Operating Spending Relative to Total Local Operating Spending	46.4
School Taxes Relative to Total Local Property Taxes	50.9

Source: Ontario Ministry of Treasury and Economics.

Appendices

GLOSSARY OF TERMS

Ad Valorem Tax - A percentage-based tax, typically applied to a measure of value such as selling price.

Basic Federal Tax - The level of tax determined by applying the federal tax rate schedule to taxable income. It is not federal tax payable, which is basic tax adjusted by credits, surtaxes or reductions. Ontario's tax rate of 50 per cent is applied to Basic Federal Tax to yield Basic Ontario Income Tax.

Budgetary Revenue - Includes revenue raised through taxation, premiums, fees, licenses and permits, payments from the federal government under fiscal arrangements and shared-cost programs, and income from investments.

Canada Assistance Plan - Federal-provincial cost-sharing mechanism for provincially-administered social assistance and welfare programs.

Capacity Utilization Rate - The actual output of an industry as a percentage of the output it could produce with its existing plant, equipment and work force.

Consolidated Public Sector Funded Debt - Funded debt incurred at all levels of Provincial jurisdiction including the Province, Ontario Hydro, municipalities, hospitals, universities and colleges.

Consumer Price Index - A monthly index measuring the retail prices of a fixed basket of goods and services purchased by consumers.

Consumption - The value of spending by consumers on goods and services, measured in current dollar terms (nominal) or adjusted for inflation (real). Consumption accounts for approximately 60 per cent of Gross National Product.

Cost-of-living Adjustment - An adjustment to incomes, wages or other payments to maintain previous purchasing power in the face of changing consumer prices.

Debt to Equity Ratio - The total debt of industrial corporations divided by total shareholders' equity.

Deductions - Reductions in the tax base, usually for specific expenses incurred in order to earn income.

Economies of Scale - Reductions in the average cost of production achieved by increasing the volume of output.

Equalization - Unconditional transfers from the federal government to qualifying provinces with the purpose of ensuring that provincial governments have sufficient revenues to provide reasonably comparable levels of public service at reasonably comparable levels of taxation.

Established Programs Financing - Unconditional federal payments to the provinces in respect of health care and post-secondary education.

Exemptions - Amounts deductible from income in recognition of specific personal circumstances.

Expenditures - Expenditures on government programs include payments for goods and services, interest on the public debt, salaries, transfer payments to individuals, municipalities and institutions, subsidies and grants, the acquisition and creation of fixed assets, and the lending, investment and trust administration activities of the Government.

Export - A good or service which is produced in one country or jurisdiction and sold to another.

Final Demand - Purchases of goods and services within the economy, excluding inventory change.

Final Domestic Demand - Purchases of goods and services within the economy, excluding the foreign sector (exports and imports) and inventory change.

Fiscal Arrangements - Institutional vehicles through which the federal government transfers funds to the provinces as part of its commitment to shared-cost programs and interprovincial fiscal capacity equalization.

Fiscal Capacity - Measure of a province's relative ability to raise revenues from available revenue sources.

Fiscal Policy - The use of the Government's spending and taxing power to regulate the aggregate level of economic activity. Expansionary fiscal policy is generally characterized by an increase in discretionary spending or a tax cut.

Fiscal Stabilization - Unconditional cash transfers from the federal government to ensure that no province's tax revenues, measured on the basis of constant tax rates and structure, plus its equalization payments, will be less than they were in the previous year.

Funded Debt - Debt which has a specified term to maturity and is secured by a debt instrument such as a bond.

Gramm-Rudman - A deficit-trimming formula proposed by U.S. Senators Gramm and Rudman which establishes a schedule of annual deficit reduction targets culminating in a balanced federal budget by 1990. If these targets are not met, the President would be required to achieve them through automatic reductions in most categories of federal government expenditures.

Gross Borrowing - Total borrowing including borrowing necessary for debt retirement purposes.

Gross Domestic Product (GDP) - The value of goods and services produced within the geographic boundaries of an area.

Gross National Product (GNP) - A nation's total output of goods and services, expressed either in current dollar value (nominal) or adjusted for

inflation (real). The percentage change in real GNP is the usual measure of the real growth rate of the economy.

Gross Provincial Product (GPP) - The value of goods and services produced within the geographic boundaries of a province; may be measured in current dollar terms (nominal) or adjusted for inflation (real).

Guaranteed Debt - Debt for which the Province agrees to meet the costs if the borrowing party can not; primarily, for Ontario Hydro.

Household Formation - Net increases in new households in a period.

Import - A good or service which has been bought from another country or jurisdiction.

Inflation - A continuing rise in the general price level.

Interest Rate - The price paid (charged) by a borrower (lender) of money. Nominal interest rates are those actually paid; real interest rates are nominal rates less the expected rate of inflation (current rates of inflation are generally used as proxies for expected rates).

Interest Service Ratio - Total interest payments taken as a per cent of cash flow of industrial corporations before interest and taxes are deducted.

Inventory - The various raw materials, parts and finished goods plus work-in-progress of a firm, and their total value.

Inventory Accumulation - An increase in the level of inventories held in the economy.

Investment - The value of spending on capital goods such as houses, plant and machinery and equipment; may be measured in current dollar terms (nominal) or adjusted for inflation (real).

Labour Force - The total number of persons, age 15 and over, who are either employed or looking for work.

Marginal Tax Rates - A schedule of rates used to determine the amount of tax payable at various taxable income levels and on each additional dollar of taxable income.

Monetary Policy - The policies of the central bank (Canada - Bank of Canada; U.S. - Federal Reserve Board) that determine the availability and cost of capital (i.e., interest rates) in the economy. Tight (anti-inflationary) monetary policy restricts growth of the money supply, thus raising interest rates and reducing inflation by squeezing demand from the economy.

Multi-Stage Sales Tax - a percentage-based tax which applies to the difference between the taxable sales and taxable purchased inputs for each transaction of the production and distribution process, such that only the value added is taxed at each stage.

Net Borrowing - Gross borrowing less borrowing needed for debt retirements.

Net Cash Requirements (NCR) - The difference between total revenue inflows to and total expenditure outflows from the Consolidated Revenue Fund.

Nominal (GNP, consumption, etc.) - In current dollars; not adjusted for inflation.

Non-Budgetary Revenue - Is the inflow of funds into the Consolidated Revenue Fund as a result of repayment of loans, deposits into pension and related benefit accounts and payments into special purpose accounts such as P.O.S.O and other trust accounts.

Non-Marketable Securities - Securities which may not be bought or sold in public capital markets.

Non-Public Borrowing - Borrowing from non-public sources of funds, usually pension funds like the Canada Pension Plan.

OECD Countries, Major - Canada, France, Italy, Japan, United Kingdom, United States, West Germany.

Operating Position - The difference between total current revenues and total current expenditures excluding capital expenditures.

Organization for Economic Cooperation and Development (OECD) - An organization of industrial nations, with a permanent staff of officials, established in 1961 to improve trade and investment flows among its members, to help analyze and deal with balance-of-payments and other economic problems and to coordinate foreign-aid policies.

Other Budgetary Revenue - Equals total budgetary revenue minus taxation revenue and payments from the federal government. Major sources include OHIP premiums, LCBO and Lottery profits, fees and licenses and interest income.

Own-Purpose Debt - Debt issued by Ontario for Provincial use only. This excludes debt issued by Ontario on behalf of Ontario Hydro.

Paid-Up Capital - For most corporations, paid-up capital funds invested in the corporation by its shareholders and other parties, loans or advances made to the corporation, and its cumulative undistributed corporate profit less its investment in other firms.

Participation Rate - The percentage of the population age 15 and over that is in the labour force.

Payroll Tax - An employment income-based tax, usually a percentage, which may be levied on the employer, employee or on both.

Per Point Yields - An estimate of direct revenue which would be gained or lost for a first unit change in relation to a specified change in tax rates.

Personal Disposable Income - The income remaining to persons for consumption or saving after deduction of income taxes, other personal direct taxes, CPP premiums, etc.

Personal Income - The income received by persons from all possible sources.

Personal Income Tax Revenue Guarantee - Federal program to ensure that amendments to the federal Income Tax Act will not reduce a province's personal income tax revenues by more than one per cent

Personal Savings Rate - Percentage of personal disposable income that is not spent for current consumption.

Prime Rate - The interest rate charged by chartered banks to their most credit-worthy customers.

Productivity - Output per unit of input (labour, capital, energy) employed.

Protectionism - Advocacy of protective tariffs and other barriers to trade as a means of developing national wealth.

Public Borrowing - Borrowing which is done through public capital markets.

Public Debt Interest - Interest paid by Ontario on total debt incurred for its own purpose.

Real (GNP, consumption, etc.) - Adjusted for inflation, constant dollars.

Real Domestic Product (RDP) -Gross domestic product adjusted for inflation.

Recession - A downturn in the business cycle characterized by weak economic activity and high unemployment. Two consecutive quarters of decline are generally considered to indicate a recession.

Recovery - The upturn of the business cycle characterized by an increase in economic activity.

Representative Tax System - A series of thirty-seven distinct revenue sources used to determine what provinces, collectively, tax.

Revenue - Includes revenue raised through taxation, premiums, fees, licences and permits, payments from the Federal Government under the Fiscal Arrangements and shared-cost programs and income from investments and earnings from advances and investments to public sector bodies.

Seasonal Adjustment (seasonally-adjusted) - A statistical adjustment to take account of seasonal factors, such as weather, so that data more accurately reflect underlying trends.

Specific Rate of Tax - A fixed rate per unit, (e.g. cigarettes will be taxed at the rate of 2.7 cent each).

Surtax - A tax additional to basic Ontario or basic federal tax, usually calculated with reference to basic tax or to taxable income.

Tariff - A tax imposed on imported goods, levied either as a percentage of their value or according to the number of units imported.

Tax Base - The taxable value to which tax rates are applied; (e.g. the taxable portion of income; or the value of goods and services taxed under the retail sales tax).

Tax Collection Agreement - The agreement between each province and the federal government that authorizes the federal government to collect that province's personal income tax. Under the current arrangements the provinces agree to calculate their tax as a percentage of basic federal tax, effectively waiving all rights to determine the tax base. Provinces are permitted limited credit and surtax/reduction programs. Some provinces have similar arrangements for corporate income taxes.

Tax Credit - A reduction of certain taxes paid, with the amount of the credit determined by a specified formula. The Ontario Tax Credits, for example, offset property and sales taxes for individuals by reducing Ontario personal income taxes. The level of this credit is a function of both the amount of tax paid and the ability to pay of the individual. As a result, credit benefits fall as income rises - effectively redistributing tax burdens in favour of lowest income individuals.

Tax Effort - Measure of the relative extent that a province actually taxes available revenue sources.

Total Debt - Funded and unfunded debt borrowed for the Province.

Unemployment Rate - The number of persons in the labour market who are unemployed, as a percentage of the labour force. The seasonally unadjusted rate is referred to by Statistics Canada as the "actual" unemployment rate.

Unfunded Debt - Debt which is not secured by a debt instrument such as deposits with the Province of Ontario Savings office.

Unit Labour Cost - A measure of productivity calculated by dividing the total wage bill by the total number of units of a good or service produced.

Value-Added - The value of a firm's output minus the value of the inputs it purchases from other firms.

Ten-Year Review of Selected Financial and Economic Statistics

($ million)

	1978-79	1979-80	1980-81	1981-82
Financial Transactions				
Revenue	13,233	15,246	16,470	18,886
Expenditure	14,413	15,830	17,273	20,389
Net Cash Requirements	1,180	584	803	1,503
Financial Position				
Total Debt	16,467	18,097	19,512	21,354
Funded Debt[1] (excluding Ontario Hydro)	14,038	15,196	16,215	17,592
Provincial Debt Transactions (net)	1,652	1,132	968	1,363
Gross Domestic Product (GDP) at Market Prices[2]	92,408	104,367	114,992	131,831
Personal Income[2]	75,832	84,607	94,407	110,028
Population - June ('000)	8,440	8,501	8,570	8,625
Funded Debt per Capita (dollars)	1,663	1,788	1,892	2,040
Personal Income per Capita (dollars)	8,985	9,953	11,016	12,757
Total Expenditure as a per cent of GDP	15.6	15.2	15.0	15.5
Net Cash Requirements as a per cent of GDP	1.3	0.6	0.7	1.1
Total Debt as a per cent of GDP	17.8	17.3	17.0	16.2
Funded Debt as a per cent of GDP	15.2	14.6	14.1	13.3
Cumulative Net Borrowing for Ontario Hydro				
U.S.	4,141	4,506	4,379	5,573
C.P.P.	–	–	500	1,000
Contingent Liabilities (mainly Ontario Hydro)	7,096	7,904	8,553	9,284

1 Funded Debt includes debentures, notes and Treasury Bills.

2. Gross Domestic Product and Personal Income are calculated on a calendar year basis. The amounts appearing in a fiscal year column are for the preceding calendar year.

3 Ontario Finances, September 30, 1987

Note: All funds are quoted in Canadian dollars.

* Before extraordinary adjustments.

** After extraordinary adjustments.

N/A - not available.

Source: Ontario Ministry of Treasury and Economics

Table C8

1982-83	1983-84	1984-85	1985-86*	1985-86**	1986-87	Interim[3] 1987-88
20,433	22,647	25,196	27,692	30,858	31,223	34,221
22,911	24,936	26,898	29,297	32,968	32,571	35,194
2,478	2,289	1,702	1,605	2,110	1,348	973
23,955	27,406	30,041	32,904	32,904	35,103	36,968
19,643	22,503	24,593	26,695	26,695	27,921	28,827
2,051	2,860	2,090	2,102	2,102	1,194	906
137,098	151,790	170,993	185,530	185,530	202,076	220,142
122,341	131,952	146,067	158,990	158,990	171,608	184,800
8,702	8,798	8,901	9,010	9,010	9,114	9,207
2,257	2,558	2,763	2,963	2,963	3,064	3,131
14,059	14,998	16,410	17,646	17,646	18,829	20,072
16.7	16.4	15.7	15.8	17.8	16.1	16.0
1.8	1.5	1.0	0.9	1.1	0.7	0.4
17.5	18.1	17.6	17.7	17.7	17.4	16.8
14.3	14.8	14.4	14.4	14.4	13.8	13.1
6,058	6,487	7,206	7,189	7,189	6,667	N/A
1,000	1,000	1,000	1,000	1,000	1,119	N/A
11,122	12,711	14,220	15,963	15,963	17,603	N/A